CERTIFICATE

Supreme Court of the United States

OCTOBER TERM, 1931

No. 547

THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA

vs.

JOSEPH S. MacLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED DECEMBER 3, 1931

(36,361)

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INDEX

	Original	Print
Certificate from United States circuit court of appeals, third circuit	1	1
Statement of facts	1	1
Question certified	4	4
Judges' signatures	4	4
Clerk's certificate (omitted in printing)	5	

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 10, 1931

[fol. 1]

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1931

No. 4669

THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, Appellant,

vs.

JOSEPH S. MACLAUGHLIN, Collector of Internal Revenue for the First District of Pennsylvania, Appellee

On Appeal from the District Court of the United States for the Eastern District of Pennsylvania

Before Buffington, Woolley, and Davis, Circuit Judges

Certificate to the Supreme Court—Filed Nov. 3, 1931

The Circuit Court of Appeals for the Third Circuit, in order to be guided to a proper decision of this case, desires the instruction of the Supreme Court, and therefore, under authority of Section 239 of the Judicial Code, certifies a question of law arising from the following facts:

STATEMENT OF FACTS

The Insurance Company of the State of Pennsylvania, appellant, plaintiff below, is a stock fire and marine insurance company, incorporated under the laws of the Commonwealth of Pennsylvania.

Joseph S. MacLaughlin, appellee, defendant below, is the Collector of Internal Revenue for the First District of Pennsylvania.

The Revenue Act of 1913 and the subsequent Acts of 1916, 1917 and 1918 taxed all insurance companies in the same manner as corporations generally. Under these Acts gain which accrued subsequent to March 1, 1913 and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the Revenue Act of 1921, however, gain by insurance companies (other [fol. 2] than mutual) from the sale or other disposition of property was no longer subject to tax nor were such com-

panies permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 re-enacted substantially the provisions of the Act of 1921 in this respect. Thus from January 1, 1921 until January 1, 1928 insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The Revenue Act of 1928, approved May 29, 1928, became effective as of January 1, 1928 as to all except certain specific provisions not here pertinent, which became effective on the date of its approval.

Section 13 of that Act imposes a tax of 12% upon the net income of corporations generally. Supplement G, which is composed of sections 201 to 208 inclusive, dealing with insurance companies, provides by Section 204 (26 U. S. C. A. Sec. 2204) as follows:

"(a) In lieu of the tax imposed by Section 13 of this Title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company 12% of its net income; * * *

(b) Definition of income, etc. In the case of an insurance company subject to the tax imposed by this section—

(1) Gross Income.—'Gross Income' means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property.

* * * * * * *

(c) Deductions Allowed.—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * * *

[fol. 3] (5) Losses sustained during the taxable year from the sale or other disposition of property; * * *"

The foregoing clauses, (b) (1) Clause (B) and (c) (5), which provide for the inclusion in the definition of 'Gross Income' of "gain during the taxable year from the sale or

other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies, are new.

The Insurance Company of the State of Pennsylvania, appellant, realized gain during the taxable year from the sale or other disposition of property. Appellee assessed and collected a tax thereon from appellant in the sum of $20,933.46 with interest of $885.89, a total of $21,819.35. Such tax was computed upon the theory that the basis to be used in computing gain or loss resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) on or after January 1, 1928, as applied to property owned on that date, under the provisions of section 204 of the Revenue Act of 1928 is the cost, the fair market value as of March 1, 1913 or other basis as provided by section 113 of the said Act.

On August 15, 1930 appellant filed with appellee its Claim for Refund of the said tax with interest so assessed in the sum of $21,819.35. Appellant's Claim for Refund of said tax was disallowed by the Commissioner of Internal Revenue on October 10, 1930. Appellant subsequently instituted the present suit against appellee to recover said sum of $21,819.35 with interest thereon from the dates upon which the same had been paid.

Appellee filed an Affidavit of Defense raising only questions of law in accordance with the Pennsylvania Practice Act of 1915. The District Court of the United States for the Eastern District of Pennsylvania (Kirkpatrick, J.) held that under the provisions of section 204 of the Revenue Act of 1928 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928 by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, [fol. 4] 1928, the effective date of the Act, and not the fair market value as of March 1, 1913 or other basis as provided by section 113 of the Act. The District Court accordingly held that as so construed the above provisions of section 204 of the Revenue Act of 1928 are constitutional. The District Court held the affidavit of defense sufficient and entered judgment for appellee and against appellant.

Appellant subsequently perfected its appeal to the Circuit Court of Appeals for the Third Circuit.

The question of law growing out of the foregoing facts upon which the Circuit Court of Appeals desires instruction by the Supreme Court is this:

QUESTION CERTIFIED

If the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property", acquired before and disposed of after January 1, 1928, the effective date of the Revenue Act of 1928, be the fair market value of such property as of March 1, 1913 or other basis provided by section 113 of the Act, is the quoted provision (section 204 (b) (1), clause (B)) unconstitutional because it taxes capital?

Joseph Buffington, Circuit Judge. Victor B. Woolley, Circuit Judge. J. Warren Davis, Circuit Judge.

[File endorsement omitted.]

[fol. 5] Clerk's certificate to foregoing paper omitted in printing.

Endorsed on cover: File No. 36,361. U. S. Circuit Court of Appeals, Third Circuit. Term No. 547. The Insurance Company of the State of Pennsylvania vs. Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania. Certificate. Filed December 3, 1931. File No. 36,361.

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IN THE

Supreme Court of the United States

No. 547. OCTOBER TERM, 1931.

THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA,

Appellant,

v.

JOSEPH S. MacLAUGHLIN, Collector of Internal Revenue For the First District of Pennsylvania,

Appellee.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, APPELLANT.

EDWARD M. BIDDLE,
1600 Arch Street,
Philadelphia, Pa.,

ROBERT C. WALKER,
ROBERT T. McCRACKEN,
1421 Chestnut Street,
Philadelphia, Pa.,
Attorneys for Appellant.

INDEX.

PAGE

I. The Opinion of the Court Below 1

II. Jurisdiction 2

III. Statement of the Case 3

IV. Argument 4

Summary of the Argument 4

(1) The power of Congress under the Sixteenth Amendment is only to lay a tax on income 5

(2) The meaning of the word "income" in Income Tax Acts is definitely settled by the decisions of this Court 6

(3) Any increased value that accrued before January 1, 1928, the effective date of the new clause in question, is capital and not income 7

(4) Comments on authorities relied on by Appellee 19

(5) Conclusion 20

AUTHORITIES AND STATUTES RELIED UPON.

CASES.

PAGE

Bowers, Collector of Internal Revenue *v.* Kerbaugh-Empire Co., 271 U. S. 170..... 6

Burnet, Commissioner of Internal Revenue *v.* Sanford and Brooks Company, 282 U. S. 359. 12

Doyle, Collector of Internal Revenue *v.* Mitchell Brothers Co., 247 U. S. 179..... 7

Hays, Collector of Internal Revenue *v.* Gauley Mountain Coal Co., 247 U. S. 189..... 13

Lynch, Collector of Internal Revenue *v.* Turrish, 247 U. S. 221..... 15

Merchants' Loan & Trust Co. *v.* Smietanka, 255 U. S. 509..... 6

Southern Pacific Co. *v.* Lowe, 247 U. S. 330...5, 17

United States *v.* Cleveland, C. C. & St. L. Ry. Co., 247 U. S. 195..... 14

STATUTES.

Revenue Act of 1928, Sections 111, 112, 113 and 204 (26 U. S. C. A. Sections 2111, 2112, 2113 and 2204).....4, 5, 18, 21, 37

U. S. Code, Title 28, Section 346..... 2

In the Supreme Court of the United States.

OCTOBER TERM, 1931. No. 547.

The Insurance Company of the State of Pennsylvania,

Appellant,

v.

Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania,

Appellee.

BRIEF FOR THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, APPELLANT.

I. THE OPINION OF THE COURT BELOW.

The opinion of the District Court for the Eastern District of Pennsylvania, by Judge Kirkpatrick, is reported in 49 Federal Reporter (2d Series) 361.

The United States Circuit Court of Appeals for the Third Circuit, without deciding the case, has certified to this Court the question involved.

The opinion of the District Court, not being included in the Certificate, is set forth in full at the end of this brief beginning at page 23 (Appendix A).

II. JURISDICTION.

The question here presented has been certified to the Supreme Court of the United States by the Circuit Court of Appeals for the Third Circuit under the authority of Section 239 of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. Code, Title 28, Section 346).

III. STATEMENT OF THE CASE.

A full statement of the case has been set forth in the Certificate of the Circuit Court of Appeals for the Third Circuit and in the interest of brevity the statement is not repeated at this point.

IV. ARGUMENT.

Summary of the Argument.

If under the new clause (b) (1) (B) of Section 204 of the Revenue Act of 1928,[1] effective January 1, 1928, the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, be the fair market value of such property as of March 1, 1913, or other basis provided by Section 113 of the Act, said new clause is unconstitutional because it taxes capital.

(1) The power of Congress under the Sixteenth Amendment is only to lay a tax on income.

(2) The meaning of the word "income" in Income Tax Acts is definitely settled by the decisions of this Court.

(3) Any increased value that accrued before January 1, 1928, the effective date of the new clause in question, is capital and not income.

(4) Comments on authorities relied on by Appellee.

(5) Conclusion.

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[1] The pertinent provisions of the Revenue Act of 1928 are set forth at page 37 of this brief as Appendix B.

(1) The power of Congress under the Sixteenth Amendment is only to lay a tax on income.

The validity of the Revenue Act of 1928, as the tax under it is not apportioned among the states, is derived from the Sixteenth Amendment. The title of the Sixteenth Amendment is "Income Tax," and the language used in the body of the Amendment states that the power given to Congress is "to lay and to collect taxes on incomes." Therefore to tax capital under the Revenue Act of 1928 is not within the power of Congress.

Under the Sixteenth Amendment for the first time Congress was empowered to tax income from property without apportioning the tax among the states according to population: **Southern Pacific Co. v. Lowe (1917), 247 U. S. 330, 335.** Any part of the Act which places a tax on capital renders such part unconstitutional and void.

The Sixteenth Amendment is as follows:

"INCOME TAX

"The congress shall have power to lay and collect taxes on incomes from whatever sources derived, without apportionment among the several states, and without regard to any census of enumeration."

(2) The meaning of the word "income" in Income Tax Acts is definitely settled by the decisions of this Court.

In the case of **Bowers, Collector of Internal Revenue v. Kerbaugh-Empire Co., 271 U. S. 170, 46 Sup. Ct. Rep. 449,** decided May 3, 1926, which presented a question arising under the Revenue Act of 1921, suit having been brought by the plaintiff to recover taxes assesesd against it and paid under protest, this Court said (p. 174):

> "'Income' has been taken to mean the same thing as used in the Corporation Excise Tax Act of 1909 (36 Stat. 112), in the Sixteenth Amendment, and in the various revenue acts subsequently passed. Southern Pacific Co. *v.* Lowe, 247 U. S. 330, 335; 38 S. Ct. 540, 62 L. Ed. 1142; Merchants' L. & T. Co. *v.* Smietanka, 255 U. S. 509, 519, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305. * * *
>
> "In determining what constitutes income substance rather than form is to be given controlling weight. Eisner *v.* Macomber, *supra,* 206 (40 S. Ct. 189)."

In the case of **Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 Sup. Ct. Rep. 386,** decided March 28, 1921, involving the income tax Act of 1916, as amended by the Act of 1917, this Court said (p. 518):

"It is obvious that these decisions (under the Corporation Excise Tax Act of August 5, 1909) in principle rule the case at bar if the word 'income' has the same meaning in the Income Tax Act of 1913 that it had in the Corporation Excise Tax Act of 1909, and that it has the same scope of meaning was in effect decided in Southern Pacific Co. *v.* Lowe, 247 U. S. 330, 335, 38 Sup. Ct. 540, 62 L. Ed. 1142, where it was assumed for the purposes of decision that there was no difference in its meaning as used in the Act of 1909 and in the Income Tax Act of 1913 (38 Stat. 114). There can be no doubt that the word must be given the same meaning and content in the Income Tax Acts of 1916 and 1917 that it had in the Act of 1913. * * * there would seem to be no room to doubt that the word must be given the same meaning in all of the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act, and that what that meaning is has now become definitely settled by decisions of this Court."

(3) Any increased value that accrued before January 1, 1928, the effective date of the new clause in question, is capital and not income.

Doyle, Collector of Internal Revenue, v. Mitchell Brothers Co., 247 U. S. 179, decided May 20,

1918, was an action to recover from the Collector additional taxes assessed against the plaintiff under the Corporation Excise Tax Act of August 5, 1909, and paid under protest, that Act having imposed on every corporation organized for profit an excise tax equivalent to one per cent. on the entire net income above $5,000 received from all sources during the year.

The plaintiff in that case was a lumber manufacturing corporation which operated its own mills, manufactured into lumber therein its own stumpage, sold the lumber in the market, and from these sales and sales of various by-products made its profits, declared its dividends and created its surplus. Plaintiff acquired certain timber lands at its organization in 1903 and paid for them at a valuation approximately equivalent to $20 per acre. Owing to increases in the market price of stumpage the market value of the timber land on December 31, 1908, had become approximately $40 per acre. The company made no entry upon its books representing this increase, but each year entered as a profit the difference between the original cost of the timber cut and the sums received for the manufactured product, less the cost of manufacture. After the passage of the Excise Tax Act, and preparatory to making a return of income for the year 1909, the company revalued its timber stumpage as of Decem-

ber 31, 1908, at approximately $40 per acre. The good faith and accuracy of this valuation were not in question, but the figures representing it never had been entered in the corporate books.

Under the act the company made a return for each of the years 1909, 1910, 1911, and 1912, and in each instance deducted from its gross receipts the market value, as of December 31, 1908, of the stumpage cut and converted during the year covered by the tax. There appears to have been no change in its market value during these years.

The Commissioner of Internal Revenue having allowed a deduction of the cost of the timber in 1903 and having refused to allow the difference between that cost and the fair market value of the timber on December 31, 1908, the question was whether this difference (made the basis of the additional taxes) was income for the years in which it was converted into money, within the meaning of the act.

After referring to the provisions of the Corporation Excise Tax Act of August 5, 1909, which became effective January 1, 1909, this Court said (p. 183):

> "An examination of these and other provisions of the act makes it plain that the legislative purpose was not to tax property as such, or the mere conversion of property, but to tax the conduct of the business of corpora-

tions organized for profit by a measure based upon the gainful returns from their business operations and property from the time the act took effect. * * *

"The formula that the entire receipts derived from a conversion of capital assets after deducting cost value must be treated as net income, so far as it is applied to a conversion of assets acquired before the act took effect and so as to tax as income any increased value that accrued before that date, finds no support in either the letter or the spirit of the act, and brings the former into incongruity with the latter. * * *

"In order to determine whether there has been gain or loss, and the amount of the gain if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

"This has been recognized from the beginning by the administrative officers of the government. Shortly after the passage of the act, and before the time (March 1, 1910) for making the first returns of income, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, promulgated Regulations No. 31, under date December 3, 1909, for the guidance of collectors and other subordinate officers in the performance of their duties under the act. * * * The matter of income arising from

a profitable sale of capital assets was dealt with specifically in such a way as to limit the tax to income arising after the effective date of the act. This was done by adopting the rule that an advance in value arising during a period of years should be so adjusted that only so much as properly was attributable to the time subsequent to January 1, 1909 (December 31, 1908, would have been more precise), should be subjected to the tax. Subsequent treasury regulations promulgated from time to time (T. D. 1606), March 29, 1910, paragraphs 40, 71, 76; T. D. 1675, February 14, 1911, paragraphs 37, 55, 75; T. D. 1742, December 15, 1911, paragraphs 43, 62, 86, 91), adhered to the same rule with respect to lands bought prior to January 1, 1909, and sold during a subsequent year, prescribing, however, that the profits, when not otherwise accurately determinable, should be prorated according to the time elapsed before and after the act took effect; and gave to it an application especially pertinent here, one of the regulations reading:

" 'The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise, it is to be accounted for in accordance with regulations

governing disposition of capital and other assets.'

"In our opinion these regulations correctly interpret the act in its application to the facts of the present case. When the act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and a subsequent change of form by conversion into money did not change the essence. Their increased value since purchase, as that value stood on December 31, 1908, was not in any proper sense the result of the operation and management of the business or property of the corporation while the act was in force. * * *

* * * the deduction did but restore to the capital in money that which had been withdrawn in stumpage cut, leaving the aggregate of capital neither increased nor decreased, and leaving the residue of the gross receipts to represent the gain realized by the conversion, so far as that gain arose while the act was in effect. This was in accordance with the true intent and meaning of the act."

That the case of Doyle *v.* Mitchell Brothers Co. *supra* is still recognized as a leading authority upon this subject by this Court is shown by a recent reference thereto by Mr. Justice Stone in the case of Burnet, Commissioner of Internal

Revenue v. Sanford and Brooks Company, 282 U. S. 359 (1930), where he says on page 364:

> "They (the expenditures in question) were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See Doyle *v.* Mitchell Bros. Co. *supra,* p. 185."

In the case of **Hays, Collector of Internal Revenue, v. Gauley Mountain Coal Co., 247 U. S. 189, 38 Sup. Ct. Rep. 470,** decided May 20, 1918, the coal company had purchased in 1902 certain shares of another mining corporation for $800,000, and sold them October 16, 1911, for $1,010,000, greater by $210,000 than cost. That case likewise was a suit to recover taxes alleged to have been unlawfully collected under the Corporation Excise Tax Act of August 5, 1909, in which this Court said (p. 192):

> "This brings us to consider whether the proceeds of the sale of stock by respondent in October, 1911, included anything, and if so how much, of 'income' accruing on or after January 1, 1909, as the term 'income' is employed in the act. * * *
>
> "It results that so much of the $210,000 of profits as may be deemed to have accrued subsequent to December 31, 1908, must be treated as a part of the 'gross income' of

the respondent. For it is the simple case of a conversion of capital assets acquired before and turned into money after the taking effect of the act; and, as we have shown in Doyle, Collector, *v.* Mitchell Brothers Co., *ante* 179, since the conversion of capital often results in gain, the general purpose of the act of 1909 to measure the tax by the increase arising from corporate activities together with the income from vested property leads to the inference that that portion of the gross proceeds which represents gain or increase acquired after the taking effect of the act must be regarded as 'gross income'; and to this end it must be distinguished from that portion which represents a return of the capital value existing before. In order to do this, it is necessary to ascertain what was the value of the capital assets on December 31, 1908."

In the case of **United States v. Cleveland, C. C. & St. L. Ry. Co., 247 U. S. 195, 38 Sup. Ct. Rep. 472,** decided May 20, 1918, which also arose under the Act of 1909, this Court said (p. 195):

"In January, 1900, the respondent purchased 30,000 shares of stock of the Chesapeake & Ohio Railway Company for $981,427.92, and sold them January 28, 1909, for $1,795,719—a profit of over $814,000. It included no portion of this profit in its return for the year 1909 under the

Corporation Excise Tax Act of August 5, 1909 (chapter 6, 36 Stat. 11, 112, Sec. 38), and the United States brought this suit to recover the tax of 1 per cent. thereon. * * *

"For reasons sufficiently stated in Doyle *v.* Mitchell Brothers Co., and Hays *v.* Gauley Mountain Coal Co., *ante* pp. 179-189, we concur in the view that defendant was not taxable except with respect to so much of the profit upon the stock as accrued after December 31, 1908."

Lynch, Collector of Internal Revenue, v. Turrish, 247 U. S. 221, 38 Sup. Ct. Rep. 537, decided June 3, 1918, was a suit to recover an income tax, paid under protest, assessed under the Act of October 3, 1913, c. 16, 38 Stat. 166.

Plaintiff's stock, acquired in 1903 for $79,975, doubled in value and he received for it $159,950 on December 31, 1913, the value on that date, however, being no greater than on March 1, 1913. The purchaser, which had an option on the stock, shortly before December 31, 1913, informed the company in which plaintiff held his stock that instead of exercising the option it preferred and proposed to purchase all of the assets of that company, paying to it such a purchase price that there would be available for distribution to its stockholders twice the par value of their stock. In this way, upon the surrender of his shares,

the plaintiff received the sum of $159,950, this being double their par value.

The plaintiff made a return of his income for the calendar year 1914, which showed he had no income for that year.

In upholding plaintiff's position that he was not subject to income tax for the year 1914, this Court said (p. 227):

> "The argument (of the government), in effect, makes any increase of value of property income, emerging as such and taxable at the moment of realization by sale or some act of separation, as by dividend declared or by distribution, as in the instant case. * * *
>
> "The latter case (Bailey *v.* Railroad Company, 22 Wall. 604, 635, 636, 22 L. Ed. 840) came here again in 106 U. S. 109, and it was then declared that the purpose of an income tax law was to tax the income for the year that it accrued; in other words, no tax in contemplation of the law accrues upon something except for the year in which that something—earnings, profits, gains or income—accrues. In that case the subject of the tax was a scrip dividend, but the certificates did not show the year of the earnings and testimony as to the particular year was admitted. The principle applies to the case at bar. If increase in value of the lands was income, it had its particular time and such time must have been within the time of the

law to be subject to the law, that is, it must have been after March 1, 1913."

In the case of **Southern Pacific Co. v. Lowe, Collector of Internal Revenue, 247 U. S. 330, 38 Sup. Ct. Rep. 540,** decided June 3, 1918, which presented a question arising under the Federal Income Tax Act of October 3, 1913, suit having been brought by plaintiff to recover taxes assessed against it and paid under protest, this Court said (p. 335):

> "Certainly the term 'income' has no broader meaning in the 1913 act than in that of 1909 (see Stratton's Independence *v.* Howbert, 231 U. S. 399, 416, 417, 34 Sup. Ct. 136, 58 L. Ed. 285), and for the present purpose we assume there is no difference in its meaning as used in the two acts. This being so, we are bound to consider accumulations that accrued to a corporation prior to January (March) 1, 1913, as being capital, not income, for the purposes of the act. And we perceive no adequate ground for a distinction, in this regard, between an accumulation of surplus earnings, and the increment due to an appreciation in value of the assets of the taxpayer. * * *
>
> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all

> sources' during each year commencing with the 1st day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; * * *."

Applying the authorities to the facts presented in the case at bar, we are led to the inevitable conclusion that the value of the capital assets of insurance companies (other than life or mutual) on December 31, 1927, represented their capital and that upon the conversion of the same into cash at a subsequent date they were entitled "to have this capital restored," to apply the language of Mr. Justice Stone in Burnet *v.* Sanford and Brooks Company, *supra,* "before there is a capital gain taxable as income," under the new provision of Section 204 of the Revenue Act of 1928.

Counsel for the government in their brief filed in the Circuit Court of Appeals attempted to minimize the effect of the foregoing cases by arguing that the language quoted from Southern Pacific *v.* Lowe, *supra,* Doyle *v.* Mitchell Brothers Co., *supra,* and Hays *v.* Gauley Mountain Coal Company, *supra,* is mere dictum and was not necessary for the decision of the questions there presented. It is submitted that these cases speak for themselves, that the language used is unequiv-

ocal, and that when Justice Pitney says, in Southern Pacific *v.* Lowe, that "We are bound to consider accumulations that accrued to a corporation prior to January (March) 1, 1913, as being capital not income," it represents the pronouncement of this Court on this subject, and until reversed must be regarded as the law of the land.

The District Court, while agreeing with counsel for Appellant that "these decisions rule the instant case," held the pertinent provision of Section 204 of the Revenue Act of 1928 constitutional because the Court refused to adopt the construction contended for by the government and held that under the provisions of Section 204 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928 by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, 1928, the effective date of the Act, and not the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act. (See Page 3 of Certificate.)

(4) Comments on Authorities relied on by Appellee.

To rebut Appellant's argument that appreciation in capital assets of insurance companies

(other than life or mutual) prior to January 1, 1928, the effective date of the new clause here under consideration constitutes capital and cannot therefore be constitutionally taxed as income, counsel for the government relied in the Circuit Court of Appeals upon several authorities. These authorities will be fully dealt with under the heading of "Comments on Authorities relied on by Appellant" (the government), in the brief filed on behalf of Alliance Insurance Company of Philadelphia, Appellee, in the companion case of Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania *v.* Alliance Insurance Company of Philadelphia, which was argued below contemporaneously with this case and which is now before this Court likewise on Certificate from the United States Circuit Court of Appeals for the Third Circuit as of October Term, 1931, No. 548. In the interest of brevity comments on such authorities are not repeated at this point.

(5) Conclusion.

It is Appellant's contention that the conclusion inevitably reached is that the gradual advance in the value of property of insurance companies (other than life or mutual insurance companies) before January 1, 1928, the effective

date of the new clause in question (Section 204 (b) (1), Clause (B) of the Revenue Act of 1928) constituted capital and therefore that said clause is unconstitutional and void, if construed as contended for by the government, because it places a tax on capital under the guise of a tax on income. Unquestionably, on December 31, 1927, before the effective date of said new clause, the increased value that had accrued on Appellant's capital assets constituted an increase of capital. Such being the situation on December 31, 1927, obviously it did not lie within the power of Congress to subsequently change the character of Appellant's assets and convert into income that which had acquired the fixed character of capital.

It follows that the amount of tax assessed and collected by Appellee from Appellant under Section 204 (b) (1) Clause (B) of the Revenue Act of 1928, which Appellant seeks to recover, was illegally assessed and collected, and that the question certified by the Circuit Court of Appeals for the Third Circuit should be answered in the affirmative.

Respectfully submitted,

EDWARD M. BIDDLE,
ROBERT C. WALKER,
ROBERT T. MCCRACKEN,
Attorneys for Appellant.

APPENDIX A.

IN THE DISTRICT COURT OF THE UNITED STATES, FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA *v.* JOSEPH S. MACLAUGHLIN, Collector of Internal Revenue for the First District of Pennsylvania.	No. 15700. September Term, 1930.

THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA *v.* JOSEPH S. MACLAUGHLIN, Collector of Internal Revenue for the First District of Pennsylvania.	No. 15702. September Term, 1930.

OPINION.

Sur Statutory Demurrer.

(Filed March 10, 1931.)

KIRKPATRICK, *J.*

In these two actions at law the plaintiffs are suing to recover income taxes paid by them for

the calendar year 1928. The cases are before the court upon statutory demurrers which, under the Pennsylvania Practice Act, admit all the facts pleaded, and the single issue in both cases is whether the assessment and collection of the taxes was legal.

The plaintiffs are stock fire insurance companies incorporated under the laws of Pennsylvania and conducting the usual business of fire insurance companies. The taxes were assessed under the Revenue Act of 1928 and were based upon gain accruing to the plaintiffs from the sale during the year 1928 of securities owned by them, and acquired prior to January 1, 1928.

The question involved is whether, in computing the amount of such gain, the basis to be used should be the fair market value of the property on March 1, 1913 or the cost if acquired after that date, and not the fair market value as of January 1, 1928, the effective date of the Revenue Act of 1928.

To see how the question arises it will first be necessary to review briefly the legislation bearing upon the question. The Revenue Act of 1913 and the subsequent Acts of 1916, 1917 and 1918 taxed all insurance companies in the same manner as corporations generally, and under these acts, gains derived from the sale or other disposition of property were taxable as income. The

Revenue Act of 1921, however, established an entirely new scheme for the taxation of insurance companies and, in Secs. 246 and 247, dealt specifically with insurance companies other than life and mutual. By the provisions of these sections such companies (which of course included stock fire insurance companies) were no longer subject to taxation upon gains from sales or other disposition of property, nor were they permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 reenacted substantially the provisions of Secs. 246 and 247 of the Act of 1921. Thus from January 1, 1921 until January 1, 1928, stock fire insurance companies were not subject to a tax upon gains derived from the sale of their property.

The attention of Congress was directed to this somewhat mysterious omission and the inequality which it produced between stock fire, casualty, and marine insurance companies on the one hand and mutuals on the other. As a result, in the Revenue Act of 1928 a clause taxing gains derived from the sale of property was added to the existing provisions for taxing insurance companies other than life or mutual, and the following provision of the Revenue Act of 1928 was enacted as part of Sec. 204:

> "(a) *Imposition of tax.* In lieu of the tax imposed by Sec. 13 of this title, there shall be

levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income, * * *"

"(b) *Definition of income, etc.* In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.* 'Gross income' means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property; * * *"

The Revenue Act of 1928 deals with insurance companies, including those here involved, in Supplement G. The general provisions of the Act appear in Subtitle A, Subtitle B, and in Supplements A, B, C, and D of Subtitle C. Sec. 4 of Subtitle A is as follows:

"The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of

taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class * * *"

Sec. 113 (a) and (b) of the Act appearing in Supplement B is as follows:

"(a) Property acquired after February 28, 1913. The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property * * *" (with certain exceptions which are not here pertinent).

"(b) Property acquired before March 1, 1913. The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) The cost of such property (or, in the case of such property as is described in subsection (a)—(1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) The fair market value of such property as of March 1, 1913, whichever is greater * * *"

The government's contention is simply that since there are no exceptions or additional provisions in Sec. 204 or, for that matter, anywhere in Supplement G, affecting the basis for determining gain or loss of stock fire, casualty or

marine insurance companies, Sec. 113 was intended to apply and to furnish the basis. It is further argued that only by so holding can stock insurance companies of the classes referred to be placed upon a parity with mutuals, since the latter in case of property sold during 1928 must compute the gain on the basis of its 1913 value.

But the statute (Title 1 of the Act) is an income tax law. The predominant intention running through all provisions is to tax income only. The Sixteenth Amendment is a grant of power to lay taxes upon incomes and the presumption is that Congress intended to act within its constitutional limits. Whatever may be read into the Act by implication must yield to a construction which will uphold the Act, unless a contrary intention is so clearly indicated as to make any other interpretation impossible with reason. This is the basis of the plaintiffs' position for they say that the construction contended for by the government would result in imposing a tax upon something not income at all but an accrual to capital matured before the passage of the Act.

A review of decisions under the Corporation Excise Tax Act of 1909 sustains the plaintiffs' view. These decisions in principle apply to the instant case, because the word "income" has the same meaning in the Income Tax Act that it had in the Corporation Excise Tax Act of 1909.

Merchant's Loan & Trust Company *v.* Smietanka, 255 U. S. 509.

In Doyle *v.* Mitchell Bros. Company, 247 U. S. 179, it was decided that an increase in value of corporate assets, the whole amount of which had accrued prior to January 1, 1909, the effective date of the Act, was not taxable although converted into money during the year 1909 at a price in excess of its value when acquired (which happened to be in 1903). The court said:

> "An examination of these and other provisions of the act makes it plain that the legislative purpose was not to tax property as such, or the mere conversion of property, but to tax the conduct of the business of corporations organized for profit by a measure based upon the gainful returns from their business operations and property from the time the act took effect * * *
>
> "The formula that the entire receipts derived from a conversion of capital assets after deducting cost value must be treated as net income, so far as it is applied to a conversion of assets acquired before the act took effect and so as to tax as income any increased value that accrued before that date, finds no support in either the letter or the spirit of the act, and brings the former into incongruity with the latter * * *
>
> "* * * In order to determine whether there has been gain or loss, and the amount

of the gain, if any, must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

"This has been recognized from the beginning by the administrative officers of the Government."

In Hays *v.* Gauley Mountain Coal Company, 247 U. S. 189, the question was as to the basis for determining income under the Act of 1909 in case of securities of another company purchased in 1902 and sold in 1911 at a large profit. It was held that so much, and only so much of the increase in value of the shares as could be deemed to have accrued after December 31, 1908, was part of the company's gross income within the meaning of the Act. In the opinion, the court said:

"* * * the general purpose of the Act of 1909 to measure the tax by the increase arising from corporate activities together with the income from invested property leads to the inference that that portion of the gross proceeds which represents gain or increase acquired after the taking effect of the act must be regarded as 'gross income'; and to this end it must be distinguished from that portion which represents a return of the capital value existing before. In order to do this,

it is necessary to ascertain what was the value of the capital assets on December 31, 1908."

These decisions rule the instant case unless they have been subsequently over-ruled or modified. The government contends that the case of Merchant's Loan & Trust Company *v.* Smietanka, 255 U. S. 509, taken in connection with the case of Smietanka *v.* First Trust & Savings Bank, 257 U. S. 602, has just such effect, because (the government says) these two decisions deal with a situation exactly parallel to that involved in the instant cases, though the subject matter was a different tax—income tax payable by trustees.

The second case (Smietanka *v.* First Trust & Savings Bank, *supra*), which was decided under the Income Tax Act of 1913 and therefore should be read first, holds merely that the Income Tax of 1913 made no provision for taxing income held and accumulated by a trustee for unborn or unascertained beneficiaries. The first case (Merchant's Loan & Trust Company *v.* Smietanka, *supra*) arose under the later acts of 1916 and 1917. The question involved was the legality of a tax upon gain realized by a trustee who, on February 2, 1917, sold assets acquired prior to March 1, 1913. The trust arose under the will of a decedent who died in 1912 leaving a widow and four children, the provision of the will being that the income

was to be paid to the widow during her life and after her death to be used for the benefit of the children or their representatives until each should arrive at the age of twenty-five when each should receive his or her share of the trust fund. The widow and the four children were all living in 1917. Thus it will be seen that all the beneficiaries were and at all times had been in esse and ascertained. The Supreme Court sustained an assessment based upon the difference between the amount realized in 1917 and the March 1, 1913 value.

Although the court in the opinion referred to the fact that the Act of 1916 specifically levied a tax upon income accumulated in trust for the benefit of unborn or unascertained persons, this provision was mentioned only as showing the intention of Congress to treat the trustee as a "taxable person." That was the real point in the case, because the tax in its entirety had been assessed against and paid by the trustee and not by the beneficiaries, either life tenant or remainder men. As applicable to a trust in which the beneficiaries were in esse and ascertained, the two decisions establish no more than this: Prior to the Act of 1916 and 1917 no tax upon gains realized from sale of property and remaining undistributed in the hands of the trustee could have been assessed against the trustee. After the

Acts referred to the trustee was a taxable person and liable for the tax.

The decision in Merchant's Loan & Trust Company *v.* Smietanka does not touch the question whether, if the tax had been assessed against the beneficiaries, it could have been sustained without resort to the Acts of 1916 and 1917 or, to put it in another way, whether, if the sale had occurred prior to 1916, the beneficiaries could have been taxed under the Act of 1913. This seems to me to be the crux of the whole question here because, if gain realized in the sale of securities by a trustee had at all times since the Act of 1913 been taxable against the beneficiaries, then the effect of the Acts of 1916 and 1917 was simply to transfer the incidence of the tax to the trustee. This was really not levying a new tax and therefore it would follow that the decision would have no bearing upon the instant case for there is no dispute that the Revenue Act of 1928 levied an entirely new tax.

Now it seems clear enough to me that the tax involved in Merchant's Loan & Trust Company *v.* Smietanka could, prior to the Acts of 1916 and 1917, have been assessed, partly at least, against the beneficiaries. The Act of 1913 provided specifically that "* * * Trustees * * * shall make and render a return of the net income of the person for whom they act * * *" and that

trustees should deduct the normal tax on the income and pay it to the United States, the surtax to be paid by the beneficiaries. The reason the trust estate in the case of Smietanka *v.* First Trust & Savings Bank, escaped taxation was that there was no person in existence for whom the trustee acted. In the other case (Merchant's Loan & Trust Company *v.* Smietanka) the persons for whom the trustee acted were in existence and were undoubtedly taxable. The fact that the income was not distributed need not have caused any difficulty since it would have been simple enough to apportion the gain among the beneficiaries so that they could be assessed with the surtax.

It is evident that the Supreme Court never intended nor understood the decision in Merchant's Loan & Trust Company *v.* Smietanka, to rule that an increase in value accruing prior to the effective date of the act imposing the tax should be included in the taxable gain. Thus in Goodrich *v.* Edwards, 255 U. S. 527, a tax was assessed upon gain measured by an increase over the market value as of March 1, 1913 (the effective date of the Act under which the tax was assessed) though the property had been purchased several years earlier at a much lower figure. The court said: "It is plain that this assessment was on the profit accruing after

March 1, 1913, the effective date of the Act. * * * The question involved is ruled by No. 608, *supra,* (Merchant's Loan & Trust Company *v.* Smietanka) and the amount was properly taxed."

Of course, if it appeared clearly and unequivocally from the terms of the Act of 1928 that Congress intended to apply the measure for gains, provided for by Sec. 113, to insurance companies of the plaintiff's class the question of constitutionality would have to be met. But there are many things in the language and structure of the Act of 1928 which strongly suggest that Congress did not so intend and I cannot agree that the conclusion that Sec. 113 was intended to apply to the tax imposed by Sec. 204 (b) (1) (B) is necessary, or even permissible. The tax imposed by Sec. 204 is expressly stated to be "in lieu of the tax imposed by Sec. 13 of this title." Sec. 13 imposed a 12% tax on the net income of corporations generally which is the amount imposed by Sec. 204 and the effect of the phrase quoted above is to emphasize the intention to make Sec. 204, a scheme or code of taxation, complete in itself, applicable to insurance companies other than life or mutual without reference to the general provisions of the Act. No other reason can be suggested for providing that a tax of 12% should be "in lieu of" a tax

at the same rate already fixed for corporations generally.

This intention appears more clearly when Sec. 204 is examined in all its parts. Whenever it was intended to incorporate into Sec. 204 any of the general provisions of the Act such provisions were specifically referred to and included by express language.

For the reasons stated, I hold that the basis for determining gain upon which the assessment was made in the case of Alliance Insurance Company of Philadelphia *v.* Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania is not authorized by law. The affidavit of defense is therefore held to be insufficient and judgment may be entered for the plaintiff in that case in the amount claimed, with interest.

It is my opinion that the said clauses of the Revenue Act of 1928 when construed in keeping with the foregoing opinion are constitutional. For this reason I hold that the affidavit of defense in the case of The Insurance Company of the State of Pennsylvania *v.* Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania is sufficient, and judgment may be entered therein for the defendant.

By the Court:

W. H. KIRKPATRICK, *J.*

APPENDIX B.

The pertinent provisions of the Revenue Act of 1928 provide as follows:

Supplement B—Computation of Net Income.

(Supplementary to Subtitle B, Part II)

SEC. 111. (26 U. S. C. A. Sec. 2111). DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * * * *

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

SEC. 112. (26 U. S. C. A. Sec. 2112). RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, * * *.

SEC. 113. (26 U. S. C. A. Sec. 2113). BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property. * * * (With exceptions not here material.)

(b) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property * * * or

(2) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

Supplement G—Insurance Companies.

SEC. 204. (26 U. S. C. A. Sec. 2204). INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance

company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income;

* * * * * * *

(b) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section——

(1) GROSS INCOME.—"Gross income" means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property;

(2) NET INCOME.—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

* * * * * * *

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * * *

(5) Losses sustained during the taxable year from the sale or other disposition of property;

* * * * * * *

FILE COPY

No. 441

In the Supreme Court of the United States

OCTOBER TERM, 1957

THE LEHIGH COMPANY OF THE STATE OF PENNSYLVANIA

v.

JOSEPH S. MACLAUGHLIN, DIRECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE COLLECTOR

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question certified	2
Statute involved	3
Statement	2
Argument	6
Conclusion	7

CITATION

Case:

MacLaughlin v. *Alliance Insurance Company of Philadelphia*, No. 548, October term, 1931 ..... 2, 6, 7

Statute:

Revenue Act of 1928, c. 852, 45 Stat. 791, 797, 818, 844, 845—

Sec. 13 (U. S. C. Sup. V, Title 26, sec. 2013) 3

Sec. 113 (U. S. C. Sup. V, Title 26, sec. 2113) 2, 6

Sec. 204 (U. S. C. Sup. V, Title 26, sec. 2204) 3, 4

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 547

THE INSURANCE COMPANY OF THE STATE OF Pennsylvania

v.

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL Revenue for the First District of Pennsylvania

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE COLLECTOR

OPINION BELOW

The opinion of the District Court for the Eastern District of Pennsylvania is reported in 49 F. (2d) 361.

JURISDICTION

The certificate of the Circuit Court of Appeals was filed in this Court December 3, 1931. (Cert. 4.) Jurisdiction is conferred upon this Court by Sec-

tion 239 of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION CERTIFIED

If the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, the effective date of the Revenue Act of 1928, be the fair market value of such property as of March 1, 1913, or other basis provided by Section 113 of the Act, is the quoted provision (Section 204 (b) (1), clause (B)) unconstitutional because it taxes capital? (Cert. p. 4.)

STATUTE INVOLVED

(The pertinent provisions of the statute are copied in Appendix A to our Brief, pp. 28–34, in No. 548, *MacLaughlin* v. *Alliance Insurance Company of Philadelphia.*)

STATEMENT

The certificate makes the following statement:

The Insurance Company of the State of Pennsylvania, appellant, plaintiff below, is a stock fire and marine insurance company, incorporated under the laws of the Commonwealth of Pennsylvania.

Joseph S. MacLaughlin, appellee, defendant below, is the Collector of Internal Revenue for the First District of Pennsylvania.

The Revenue Act of 1913 and the subsequent Acts of 1916, 1917, and 1918 taxed all insurance companies in the same manner as corporations generally. Under these Acts gain, which accrued subsequent to March 1, 1913, and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the Revenue Act of 1921, however, gain by insurance companies (other than mutual) from the sale or other disposition of property was no longer subject to tax nor were such companies permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 re-enacted substantially the provisions of the Act of 1921 in this respect. Thus, from January 1, 1921, until January 1, 1928, insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The Revenue Act of 1928, approved May 29, 1928, became effective as of January 1, 1928, as to all except certain specific provisions not here pertinent, which became effective on the date of its approval.

Section 13 of that Act imposes a tax of 12 per cent upon the net income of corporations generally. Supplement G, which is composed of Sections 201 to 208, inclusive, dealing with insurance companies, provides by Section 204 [c. 852, 45 Stat. 791, 844, 845; U. S. C., Sup. V, Title 26, sec. 2204] as follows:

(a) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12% of its net income;

* * * * *

(b) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.*—"Gross income" means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property;

* * * * *

(c) *Deductions Allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year from the sale or other disposition of property;

* * * * *

The foregoing clauses, (b) (1) clause (B) and (c) (5), which provide for the inclusion in the definition of "Gross income" of "gain during the taxable year from the sale or other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in com-

puting the net income of such insurance companies, are new.

The Insurance Company of the State of Pennsylvania, appellant, realized gain during the taxable year from the sale or other disposition of property. Appellee assessed and collected a tax thereon from appellant in the sum of $20,933.46 with interest of $885.89, a total of $21,819.35. Such tax was computed upon the theory that the basis to be used in computing gain or loss resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) on or after January 1, 1928, as applied to property owned on that date, under the provisions of Section 204 of the Revenue Act of 1928 is the cost, the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the said Act.

On August 15, 1930, appellant filed with appellee its Claim for Refund of the said tax with interest so assessed in the sum of $21,819.35. Appellant's Claim for Refund of said tax was disallowed by the Commissioner of Internal Revenue on October 10, 1930. Appellant subsequently instituted the present suit against appellee to recover said sum of $21,819.35 with interest thereon from the dates upon which the same had been paid.

Appellee filed an Affidavit of Defense, raising only questions of law in accordance with the Pennsylvania Practice Act of 1915. The District Court of the United States for the Eastern District of

Pennsylvania (Kirkpatrick, J.) held that, under the provisions of Section 204 of the Revenue Act of 1928 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928, by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, 1928, the effective date of the Act, and not the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act. The District Court accordingly held that, as so construed, the above provisions of Section 204 of the Revenue Act of 1928 are constitutional. The District Court held the affidavit of defense sufficient and entered judgment for appellee and against appellant.

Appellant subsequently perfected its appeal to the Circuit Court of Appeals for the Third Circuit.

ARGUMENT

The form of the question is hypothetical, and until the question of statutory construction is determined no constitutional question can arise. It may be that because the question as to the proper construction of the statute is certified by the same court in *MacLaughlin* v. *Alliance Insurance Co.* (No. 548) the hypothetical nature of the question may be ignored. If not, the certificate, of course, must be dismissed.

The question whether the application of the basis prescribed by Section 113 of the Revenue Act of 1928, to the determination of gain upon the sale of

property by a stock fire insurance company renders the taxation of such gains unconstitutional is argued on pp. 20–27 of the Brief for the Collector in *Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania*, v. *Alliance Insurance Company of Philadelphia*, No. 548, October Term, 1931, now pending upon a certificate from the United States Circuit Court of Appeals for the Third Circuit filed on the same date as the certificate in the instant case.

The facts stated in the instant certificate are substantially the same as the facts stated in case No. 548, and the argument in that case is applicable here.

CONCLUSION

We respectfully submit that the question certified should be answered in the negative.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
Special Assistants to the Attorney General.
WILLIAM H. RILEY, JR.,
Attorney.

FEBRUARY, 1932.

U. S. GOVERNMENT PRINTING OFFICE: 1932

CLERK'S COPY.

CERTIFICATE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 548

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

vs.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED DECEMBER 3, 1931

(36362)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 548

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

vs.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Original	Print
Certificate from U. S. C. C. A., Third Circuit	1	1
Statement of facts	1	1
Question certified	4	3
Judges' signatures	4	3
Clerk's certified [omitted in printing]	5	3

1 In United States Circuit Court of Appeals for the Third Circuit

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of Pennsylvania, appellant

vs.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, APPELLEE

No. 4642. October term, 1931

On appeal from the District Court of the United States for the Eastern District of Pennsylvania

Before BUFFINGTON, WOOLLEY and DAVIS, Circuit Judges

CERTIFICATE TO THE SUPREME COURT

Filed November 23, 1931

The Circuit Court of Appeals for the Third Circuit, in order to be guided to a proper decision of this case, desires the instruction of the Supreme Court, and therefore, under authority of section 239 of the Judicial Code, certifies a question of law arising from the following facts:

Statement of facts

The Alliance Insurance Company of Philadelphia, appellee, plaintiff below, is a stock fire and marine insurance company, incorporated under the laws of the Commonwealth of Pennsylvania.

Joseph S. MacLaughlin, appellant, defendant below, is the collector of internal revenue for the first district of Pennsylvania.

2 The revenue act of 1913 and the subsequent acts of 1916, 1917, and 1918 taxed all insurance companies in the same manner as corporations generally. Under these acts gain which accrued subsequent to March 1, 1913, and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the revenue act of 1921, however, gain by insurance companies (other than mutual) from the sale or other disposition of property was no longer subject to tax nor were such companies permitted to deduct losses sustained in like manner. The revenue acts of 1924 and 1926 reenacted substantially the provisions of the act of 1921 in this respect. Thus from January 1, 1921, until January 1, 1928, insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The revenue act of 1928, approved May 29, 1928, became effective as of January 1, 1928, as to all except certain specific provisions not here pertinent, which became effective on the date of its approval.

Section 13 of that act imposes a tax of 12% upon the net income of corporations generally. Supplement G, which is composed of sections 201 to 208, inclusive, dealing with insurance companies, provides by section 204 (26 U. S. C. A. sec. 2204) as follows:

"(a) In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

"(1) In the case of such a domestic insurance company 12% of its net income; * * *

"(b) Definition of income, etc. In the case of an insurance company subject to the tax imposed by this section—

"(1) Gross income.—'Gross income' means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property.

3 "(c) Deductions allowed.—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * * *

"(5) Losses sustained during the taxable year from the sale or other disposition of property; * * *"

The foregoing clauses, (b) (1) clause (B) and (c) (5), which provide for the inclusion in the definition of "gross income" of "gain during the taxable year from the sale or other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies, are new.

The Alliance Insurance Company of Philadelphia, appellee, realized gain during the taxable year 1928 from the sale or other disposition of property acquired prior to January 1, 1928, and paid a tax thereon. Joseph S. MacLaughlin, appellant, assessed and collected an additional tax from appellee of $4,153.37 with interest of $199.19, a total of $4,352.56, upon additional gain alleged to have been realized by appellee from the sale or other disposition of such property during the taxable year 1928. The additional tax so collected was computed by appellant upon the theory that the basis to be used in computing gain resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) on or after January 1, 1928, as applied to property acquired prior to that date, under the provisions of section 204 of the revenue act of 1928 is the cost, the fair market value as of March 1, 1913, or other basis as provided by section 113 of the act and not the fair market value as of January 1, 1928, the effective date of the act. The additional tax so assessed represents the excess over the amount of the tax that would have been assessed if the gain had been determined on the basis of the value of the property in question as of January 1, 1928, the basis used by appellee, instead of on the basis provided in section 113 of the act.

4 On August 15, 1930, appellee filed with appellant its claim for refund of the additional tax with interest so assessed in the sum of $4,352.56. Appellee's claim for refund of said tax was disallowed by the Commissioner of Internal Revenue on October 10, 1930. Appellee subsequently instituted the present suit against appellant to recover said sum of $4,352.56 with interest thereon from April 19, 1930, the date appellee paid said additional tax to appellant.

Appellant filed an affidavit of defense, raising only questions of law, in accordance with the Pennsylvania practice act of 1915. The District Court of the United States for the Eastern District of Pennsylvania (Kirkpatrick, J.) held that under the provisions of section 204 of the revenue act of 1928 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928, by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, 1928, the effective date of the act, and not the fair market value as of March 1, 1913, or other basis as provided by section 113 of the act. The District Court accordingly held the affidavit of defense insufficient and entered judgment for appellee in the amount claimed with interest.

Appellant subsequently perfected his appeal to the Circuit Court of Appeals for the Third Circuit.

The question of law growing out of the foregoing facts upon which the Circuit Court of Appeals desires instruction by the Supreme Court is:

Question certified

Under the revenue act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the act?

JOSEPH BUFFINGTON,
Circuit Judge.
VICTOR B. WOOLLEY,
Circuit Judge.
J. WARREN DAVIS,
Circuit Judge.

[File indorsement omitted.]

5 [Clerk's certificate to foregoing paper omitted in printing.]

6 [Indorsement on cover:] Enter Attorney General. File No. 36,362. U. S. Circuit Court of Appeals, Third Circuit. Term No. 548. Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania *vs.* Alliance Insurance Company of Philadelphia. Certificate. Filed December 3, 1931. File No. 36,362.

U. S. GOVERNMENT PRINTING OFFICE: 1931

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No. 548

In the Supreme Court of the United States

OCTOBER TERM, 1931

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

v.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE COLLECTOR

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question certified	2
Statute involved	2
Statement	2
Summary of argument	6
Argument:	
I. The Revenue Act of 1928 provides that the basis for computing gain on the sale of property sold in 1928 is its cost or its value on March 1, 1913, if it was acquired prior to that date and was on that date worth more than its cost	9
II. There is no room for doubt as to the constitutionality of Sections 111, 113, and 204 of the Act as construed by the Treasury Department	20
Conclusion	27
Appendix A (Statutes)	28
Appendix B (Treasury Regulations)	35
Appendix C (Legislative history)	39

CITATIONS

Cases:

Brushaber v. *Union Pac. R. R.*, 240 U. S. 1	20
Cooper v. *United States*, 280 U. S. 409	8, 20, 21, 24
Doyle v. *Mitchell Brothers Co.*, 247 U. S. 179	25
Eisner v. *Macomber*, 252 U. S. 189	24
Eldorado Coal Co. v. *Mager*, 255 U. S. 522	21
Fawcus Machine Co. v. *United States*, 282 U. S. 375	21
Goodrich v. *Edwards*, 255 U. S. 527	21, 24
Hays v. *Gauley Mt. Coal Co.*, 247 U. S. 189	25
Knowlton v. *Moore*, 178 U. S. 41	19
Lucas v. *Alexander*, 279 U. S. 573	21, 24
Lynch v. *Turrish*, 247 U. S. 221	25
Merchants L. & T. Co. v. *Smietanka*, 255 U. S. 509	21, 22, 27
Milliken v. *United States*, 283 U. S. 15	20
Southern Pacific Co. v. *Lowe*, 247 U. S. 330	25
Taft v. *Bowers*, 278 U. S. 470	8, 21, 24
Untermyer v. *Anderson*, 276 U. S. 440	20
Walsh v. *Brewster*, 255 U. S. 536	21
Willcuts v. *Bunn*, 282 U. S. 216	21

Statutes: Page

Tariff Act of 1913, c. 16, 38 Stat. 114, 166—
Section II 26
Revenue Act of 1916, c. 463, 39 Stat. 756, 757, 765—
Section 2 26
Section 10 ..... 23, 26
Revenue Act of 1917, c. 63, 40 Stat. 300, 302, 303, 329—
Section 200 26
Section 201 26
Section 1200 26
Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1075—
Section 1 26
Section 202 23
Section 213 26
Section 230 26
Revenue Act of 1921, c. 136, 42 Stat. 227, 229, 237, 254, 261—
Section 2 19
Section 202 ..... 19, 23
Section 213 26
Section 233 26
Section 242 19
Section 243 19
Section 244 19
Section 245 19
Section 246 ..... 19, 26
Revenue Act of 1924, c. 234, 43 Stat. 253, 260, 267, 283, 289—
Section 2 19
Section 204 (U. S. C. Title 26, sec. 936) 19, 23
Section 213 (U. S. C. Title 26, sec. 955) 26
Section 233 (U. S. C. Title 26, sec. 985) 26
Section 242 19
Section 243 (U. S. C. Title 26, sec. 1001) 19
Section 244 (U. S. C. Title 26, sec. 1003) 19
Section 245 (U. S. C. Title 26, sec. 1004) 19
Section 246 (U. S. C. Title 26, sec. 1006) 19, 26
Revenue Act of 1926, c. 27, 44 Stat. 9, 11, 12, 14, 23, 41, 47, 48—
Section 2 19
Section 202 (U. S. C. App. Title 26, sec. 933) 19
Section 203 (U. S. C. App. Title 26, sec. 934) 19
Section 204 (U. S. C. App. Title 26, sec. 935) 19, 23
Section 213 (U. S. C. App. Title 26, sec. 954) 26
Section 233 (U. S. C. App. Title 26, sec. 985) 26
Section 242 19
Section 243 (U. S. C. App. Title 26, sec. 1001) 19
Section 244 (U. S. C. App. Title 26, sec. 1003) 19
Section 245 (U. S. C. App. Title 26, sec. 1004) 19
Section 246 (U. S. C. App. Title 26, sec. 1006) 19, 26

Statutes—Continued.

	Page
Revenue Act of 1928, c. 852, 45 Stat. 791, 795, 799, 810, 815, 816, 821, 826, 831, 844, 846—	
Section 1 (U. S. C. Sup. V, Title 26, sec. 2001)	28
Section 3 (U. S. C. Sup. V, Title 26, sec. 2003)	28
Section 4 (U. S. C. Sup. V, Title 26, sec. 2004)	29
Section 23 (U. S. C. Sup. V, Title 26, sec. 2023)	14
Section 111 (U. S. C. Sup. V, Title 26, sec. 2111)	30
Section 112 (U. S. C. Sup. V, Title 26, sec. 2112)	30
Section 113 (U. S. C. Sup. V, Title 26, sec. 2113)	30
Section 141 (U. S. C. Sup. V, Title 26, sec. 2141)	14
Section 204 (U. S. C. Sup. V, Title 26, sec. 2204)	31
Section 207 (U. S. C. Sup. V, Title 26, sec. 2207)	14
Section 208 (U. S. C. Sup. V, Title 26, sec. 2208)	12, 19
Miscellaneous:	
Conference Report No. 1882, 70th Cong., 1st sess., p. 18	47
Congressional Record, Vol. 69, part 9, p. 9337	44
H. R. 1, Revenue Bill of 1928, 70th Cong., 1st sess., Section 204 (b)	43, 44
H. R. No. 2 (to accompany H. R. 1), 70th Cong., 1st sess., p. 12	41
H. Doc. No. 139, 70th Cong., 1st sess.	39
I. T. 2444, VII-2 C. B. 63	37
Senate Report No. 960, 70th Cong., 1st sess., p. 18	43
Treasury Regulations 74—	
Article 991	35
Article 992	36

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 548

JOSEPH S. MACLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

v.

ALLIANCE INSURANCE COMPANY OF PHILADELPHIA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE COLLECTOR

OPINION BELOW

The opinion of the District Court is reported in 49 F. (2d) 361.

JURISDICTION

The certificate of the Circuit Court of Appeals was filed in this Court on December 3, 1931. (Cert., p. 3.) Jurisdiction is conferred upon this Court by Section 239 of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION CERTIFIED

Under the Revenue Act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the Act? (Cert., p. 3.)

STATUTE INVOLVED

(The pertinent provisions of the statute are copied in Appendix A, pp. 28–34, *infra.*)

STATEMENT

The certificate makes the following statement:

The Alliance Insurance Company of Philadelphia, appellee, plaintiff below, is a stock fire and marine insurance company, incorporated under the laws of the Commonwealth of Pennsylvania.

Joseph S. MacLaughlin, appellant, defendant below, is the Collector of Internal Revenue for the First District of Pennsylvania.

The Revenue Act of 1913 and the subsequent acts of 1916, 1917, and 1918 taxed all insurance companies in the same manner as corporations generally. Under these Acts gain which accrued subsequent to March 1, 1913, and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the Revenue Act of 1921, however, gain by insurance companies (other than mutual) from the sale or other

disposition of property was no longer subject to tax nor were such companies permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 reenacted substantially the provisions of the Act of 1921 in this respect. Thus from January 1, 1921, until January 1, 1928, insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The Revenue Act of 1928, approved May 29, 1928, became effective as of January 1, 1928, as to all except certain specific provisions not here pertinent, which became effective on the date of its approval.

Section 13 of that Act imposes a tax of 12 per cent upon the net income of corporations generally. Supplement G, which is composed of Sections 201 to 208, inclusive, dealing with insurance companies, provides by Section 204 [c. 852, 45 Stat. 791, 844, 845; U. S. C. Sup. V, Title 26, sec. 2204] as follows:

> (*a*) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company, 12% of its net income;
>
> * * * * *
>
> (*b*) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property;

* * * * *

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year from the sale or other disposition of property;

* * * * *

The foregoing clauses, (b) (1) clause (B) and (c) (5), which provide for the inclusion in the definition of "Gross income" of "gain during the taxable year from the sale or other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies, are new.

The Alliance Insurance Company of Philadelphia, appellee, realized gain during the taxable year 1928 from the sale or other disposition of property acquired prior to January 1, 1928, and paid a tax thereon. Joseph S. MacLaughlin, appellant, assessed and collected an additional tax from appellee of $4,153.37 with interest of $199.19, a total of $4,352.56, upon additional gain alleged to have been realized by appellee from the sale or other disposi-

tion of such property during the taxable year 1928. The additional tax so collected was computed by appellant upon the theory that the basis to be used in computing gain resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) on or after January 1, 1928, as applied to property acquired prior to that date, under the provisions of Section 204 of the Revenue Act of 1928 is the cost, the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act and not the fair market value as of January 1, 1928, the effective date of the Act. The additional tax so assessed represents the excess over the amount of the tax that would have been assessed if the gain had been determined on the basis of the value of the property in question as of January 1, 1928, the basis used by appellee, instead of on the basis provided in Section 113 of the Act.

On August 15, 1930, appellee filed with appellant its claim for refund of the additional tax with interest so assessed in the sum of $4,352.56. Appellee's claim for refund of said tax was disallowed by the Commissioner of Internal Revenue on October 10, 1930. Appellee subsequently instituted the present suit against appellant to recover said sum of $4,352.56 with interest thereon from April 19, 1930, the date appellee paid said additional tax to appellant.

Appellant filed an affidavit of defense, raising only questions of law, in accordance with the Penn-

sylvania Practice Act of 1915. The District Court of the United States for the Eastern District of Pennsylvania (Kirkpatrick, J.) held that under the provisions of Section 204 of the Revenue Act of 1928 the basis to be used in computing gain from the sale or other disposition of property owned on January 1, 1928, by insurance companies (other than life or mutual insurance companies) is the fair market value as of January 1, 1928, the effective date of the Act, and not the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act. The District Court accordingly held the affidavit of defense insufficient and entered judgment for appellee in the amount claimed with interest. Appellant subsequently perfected his appeal to the Circuit Court of Appeals for the Third Circuit. (Cert., pp. 1–3.)

SUMMARY OF ARGUMENT

This case concerns only sales in 1928 of securities which were purchased prior to that year. We submit that the Commissioner's method of computing the taxable gain on them was correct. He calculated the gain upon the basis prescribed in Section 113 of the Act, i. e., he took as the basis the cost of the property, except in the case of such securities as were acquired prior to March 1, 1913, and which were worth more on that date than their cost, and as to such property he took as a basis the value on March 1, 1913.

The statute contemplates that this basis, provided in Section 113, shall be applicable to gains from sales of property by stock fire insurance companies. Section 111 provides that the basis provided in Section 113 shall apply "except as hereinafter provided in this section." There is no provision in the section excepting such insurance companies from its application. Although Section 204, which imposes the tax on such insurance companies and provides that their gross income shall include "gain during the taxable year from the sale or other disposition of property," does not expressly refer to Sections 111 or 113, it is clear from Section 4 in the introductory provisions, as well as from the structure of the Act as a whole, that general provisions like those of Sections 111 and 113 are to apply to all taxpayers taxed on gains on sales of property unless some other specific provision forbids. There is no provision expressly or inferentially forbidding the application of Sections 111 and 113 to insurance companies taxed under Section 204.

The legislative history of Section 204 shows that Congress intended that in respect of gains, stock fire insurance companies should be treated in the same manner as mutual fire insurance companies, and it is clear that both under the 1928 Act and earlier Acts the basis for computing gains on sales of property by mutual fire insurance companies was that which was here applied by the Commissioner.

The Commissioner's action accords with the construction of the Act which has been consistently adopted by the Treasury Department in formal regulations and other rulings.

There is no room for doubt as to the constitutionality of Sections 111, 113, and 204 of the Act as construed by the Treasury Department. This Court has in several cases considered and overruled the contention that gains on sales of securities accruing since the effective date of the Sixteenth Amendment may not be taxed under that Amendment. But until the provision here involved was attacked, it seems never to have been argued that if any gains on sales are taxable, Congress cannot by an Act passed after the effective date of the Sixteenth Amendment require the inclusion in gross income of all gains which have accrued since that date. Congress has taxed such gains generally, although the Revenue Acts of 1921, 1924, and 1926 did not include such gains in the taxable income of stock fire insurance companies. The exemption from such taxes thus enjoyed for a time did not deprive Congress of the power in 1928 to tax this class of taxpayers on such gains upon the same basis as other corporations. The fact that some of the appreciation in value occurred during the period when no tax was levied on sales resulting in gains is immaterial. Cf. *Cooper* v. *United States*, 280 U. S. 409; *Taft* v. *Bowers*, 278 U. S. 470.

ARGUMENT

I

THE REVENUE ACT OF 1928 PROVIDES THAT THE BASIS FOR COMPUTING GAIN ON THE SALE OF PROPERTY SOLD IN 1928 IS ITS COST OR ITS VALUE ON MARCH 1, 1913, IF IT WAS ACQUIRED PRIOR TO THAT DATE AND WAS ON THAT DATE WORTH MORE THAN ITS COST

The tax on insurance companies (other than life or mutual companies) is imposed by Section 204 of the Act. (See p. 31, *infra.*) Paragraph (b) (1) of this section provides that—

> "Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, * * * and (B) gain during the taxable year from the sale or other disposition of property; * * *

Neither in Section 204 nor any other section relating solely to insurance companies is there any other provision relating to such gain. If the Act specified no basis for computing such gain, the above provision would seem to require the inclusion of all gain realized during the year, i. e., the difference between the proceeds of the sale and the cost of the property, at least to the extent which it could constitutionally be taxed. But the Act does specifically prescribe a basis. Section 111 provides:

> (*a*) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of

property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

There is no provision in Section 111 excepting any insurance company from its operation. Section 113 contains the following provisions:

(*a*) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; [with exceptions not here important].

(*b*) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property [with exceptions not here important], or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

It seems clear to us that these provisions of Section 113 are applicable to sales of property by all types of taxpayers who are required to include profits on sales in their gross income.

An examination of the 1928 Act discloses that its structure is peculiar and different from that of any

other tax Act. "Title I—Income Tax" is all that need be considered here, as the other Titles relate to other types of taxes, etc. Title I is divided into three subtitles, designated as follows:

"Subtitle A—Introductory Provisions,"
"Subtitle B—General Provisions,"
"Subtitle C—Supplemental Provisions."

The purpose of Subtitle A is evidently to give a classification or summary of the other headings of the Act and also to show that all of the provisions of Title I (except Supplements E–K) apply to all parts of that Title except in so far as they are modified by more specific provisions applicable to special classes of taxpayers. Section 4 of Subtitle A provides in part as follows:

> The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:
>
> (*a*) Estates and trusts and the beneficiaries thereof,—Supplement E.
>
> (*b*) Members of partnerships,—Supplement F.
>
> (*c*) Insurance companies,—Supplement G.
>
> (*d*) Nonresident alien individuals,—Supplement H.
>
> (*e*) Foreign corporations,—Supplement I.

The obvious purpose of this new arrangement was that all of the general provisions in Sub-

title B and all of the general provisions of Supplements A-D (including Supplement B in which Section 113 occurs) should apply to the special classes of taxpayers referred to in Supplements E to K unless there is something in the special provisions relating to a class which makes an express exception or is necessarily inconsistent with the general provisions.

This view is confirmed by an examination of the entire Act. The statements of the District Court that Section 204 (which imposes the tax here involved) is "a scheme or code of taxation, complete in itself, * * * without reference to the general provisions of the act," and that "Whenever it was intended to incorporate into section 204 any of the general provisions of the act, such provisions were specifically referred to and included by express language" appear to be erroneous upon such an examination of the Act.

Thus "Supplement G," relating to insurance companies, even in its entirety, consisting of Sections 201–208, inclusive, is not complete in itself. Sections 201–203 relate to the tax on life insurance companies; Section 204 to that on insurance companies other than life or mutual companies; Sections 205–207 contain provisions applying to the taxes imposed both by Sections 201 and 204; and Section 208 applies to mutual insurance companies other than life companies. All of the provisions of "Supplement G" together (i. e., Sections 201–208) occupy less than five pages of

the Statutes at Large (45 Stat. 842–846). This is in marked contrast with the provisions applicable to corporations generally, including as they do Sections 13 to 149 (with a few exceptions), and occupying about forty pages of the Statutes at Large (45 Stat. 797–837). Congress must have intended that many of these provisions in Sections 13 to 149 should be applicable to insurance companies for otherwise the statute in its application to insurance companies would be quite incomplete.

Thus, for example, there is no express reference in Section 204 or in any other part of Supplement G to the following sections, which are the only sections in the Act covering the matters to which they relate: Section 52, requiring corporations to file returns; Section 56, specifying the time for payment of tax; Section 104, forbidding accumulation of surplus to avoid surtaxes; Section 105, providing for the taxable period embracing years with different laws; Section 118, disallowing losses on sales of securities if within thirty days of the sale the taxpayer buys substantially identical property; Sections 141 and 142, relating to consolidated returns; Section 146, penalizing taxpayers for willful failure to pay the tax, to make returns and the like. Other essential provisions which are not included in Section 204 by reference or otherwise are found in Sections 271–277, providing for assessment and collection of deficiencies, including provisions relating to the Board of Tax Appeals and statute of limitations; Sections 291–299, relating to interest

and additions to the tax; Section 311, relating to transferred assets; and Section 322, relating to refunds and credits. Such provisions by virtue of their generality and the provisions of Section 4 of Subtitle A are, we submit, applicable to insurance companies.

Section 141(e) shows the intention of Congress that the general provisions should apply to insurance companies unless specific provision to the contrary was made.

Moreover, it is noteworthy that Section 207 in Supplement G, expressly provides that gross income "shall *not* be determined in the manner provided in Section 119." This plainly indicates that the general provisions of Section 119 would apply to insurance companies in the absence of express exception. It is true that Sections 204, 205, and 206 do incorporate by reference provisions of certain general sections. Thus, Section 204, in listing ten deductions allowed in computing the net income of an insurance company subject to the tax imposed by this Section, includes six items in which some part of Section 22 or Section 23 is incorporated by reference, such as "Taxes as provided in Section 23(c)." The list of deductions was intended to be exclusive and it was therefore necessary in this case to incorporate the deductions authorized under Sections 22 and 23 if they were to be allowed.

Deductions allowed insurance companies differ in many respects from those allowed other cor-

porations. The method adopted was a short and convenient one for indicating just what deductions insurance companies are to have. No such situation is presented in regard to that provision of Section 204(b), which states that gross income shall include "gain during the taxable year from the sale or other disposition of property," since Section 204 contains no other provisions in regard to such gain. The general provisions in regard to determination of gains, Sections 111–113, cover many questions which must arise in connection with sales of property by insurance companies. There is no provision in Section 204 or elsewhere in Supplement G specifying the basis on which losses on sales of property are to be computed.

Although, as we have stated, there are in the sections relating to insurance companies a few references to the general provisions of the Act, the usual treatment seems to have been not to make reference to other provisions of the Act, but rather to rely upon the introductory provisions of Section 4 (p. 11, *supra*) as sufficient to impose such provisions upon insurance companies, except in so far as there are express exceptions or obviously inconsistent provisions. This scheme of the statute is applied to other special classes of taxpayers, such as estates (provided for in Supplement E) and nonresident alien individuals (provided for in Supplement H). Many of the general provisions of the Act not contained in Supplements E and H obviously were intended to apply to the taxpayers covered by these

supplements. Congress apparently intended that they should be applicable and inserted no provisions either in Supplement E or Supplement H making them applicable because Section 4 of Subtitle A was intended to have this effect.

Nor do we agree with the meaning attributed by the District Court to the following introductory language of Section 204(a):

> In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company, 12 per centum of its net income.

It was necessary, or at least desirable, to state that the tax imposed by this section was "in lieu of the tax imposed by section 13" so as to make it perfectly clear that an insurance company is not subject to both taxes, inasmuch as Section 13 imposes a tax "upon the net income of every corporation" and Section 701 defines the term "corporation" to include insurance companies. Although the tax imposed by Section 204 was at the same rate as the tax on ordinary corporations, the net income upon which it was based was computed in a different manner.

The taxpayer has argued that if Congress had intended to apply to insurance companies the basis of determining gain provided in Section 113, it

would have referred specifically to this section, but, as we have pointed out, the usual method was not to refer to specific sections. There is more reason to say that if Congress had intended by Section 204 to prescribe a basis for determining gains different from that carefully detailed in this Act and different from any basis ever employed in any Act, it would have definitely specified the novel basis. Moreover, it is worthy of notice that the provision placing capital gain in the gross income of insurance companies was inserted in Section 204 by amendment to the bill on the floor of the Senate after it had passed the House. (See pp. 43–44, *infra.*) It is to be presumed that an amendment thus proposed was not intended to result in a novel basis for computing capital gain to which no reference is made in the amendment.

Indeed, if any doubt exists as to the intention of Congress that Section 113 should apply to gains taxed under Section 204, that doubt is resolved in favor of our view by the legislative history of the Act. A report of the Joint Committee on Internal Revenue Taxation (made up of members of both Houses) made certain recommendations which were adopted, as is shown by the Report of the Ways and Means Committee which accompanied the Revenue Act of 1924. (Pertinent extracts from these reports appear on pp. 39–41, *infra.*) The report of the Joint Committee stated:

> A recommendation was approved that the act be rearranged so as to collect at one place (preferably the beginning of the act) the general provisions which apply to the cases of practically all taxpayers, and to carry to appropriate places at subsequent parts of the act the special provisions which apply only to the occasional transaction or to particular classes of tax cases.

This recommendation was adopted. Although the provision regarding taxation of gains on sales of property did not appear in the bill as then presented, the statement quoted above does support our contention as to the meaning of the introductory clauses in Section 4 of the bill, which, if correct, destroys most of the argument of the taxpayer.

After the bill had passed the House, and while it was being considered in the Senate, Senator Reed of Pennsylvania proposed as an amendment the insertion in Section 204 (b) (1) of the words "(B) gain during the taxable year from the sale or other disposition of property." In explanation, he said that, in respect of this item, the amendment would put stock insurance companies "on the same basis" as mutual companies. (For a full report of his statements, see pp. 44–46, *infra.*) It is perfectly clear that mutual insurance companies under the 1928 Act, as well as under previous Acts, were required to compute gains on sales of prop-

erty upon the basis of cost or value on March 1, 1913, if that was greater.[1]

In this situation the language of this Court in *Knowlton* v. *Moore*, 178 U. S. 41, is particularly apposite. It was there said (p. 77):

> We are, therefore, bound to give heed to the rule, that where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute.

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[1] The following provisions of various Acts lead to this conclusion: Section 2 (2) of the Revenue Act of 1921 (c. 136, 42 Stat. 227) defines corporations as including insurance companies. Sections 2 (2) of the 1924 (c. 234, 43 Stat. 253) and the 1926 Acts (c. 27, 44 Stat. 9) contain the same definition. Section 246 of the 1921, 1924, and 1926 Acts provide for taxation of all insurance companies other than life or mutual. Sections 242 to 245 of the same Acts provide for the taxation of life insurance companies. There are no provisions in any of these Acts specifically referring to mutual companies, and consequently they are taxed in the same manner as other corporations. Section 202 of the 1921 Act and Sections 202, 203, and 204 of the 1924 and 1926 Acts specify the manner of determining gains. Section 208 of the 1928 Act (c. 852, 45 Stat. 791) states that mutual insurance companies shall be taxable in the same manner as other corporations with certain exceptions, none of which deal with gains or losses. Sections 113 (a) of the 1928 Act, 204 (a) of the 1924 and 1926 Acts, and 202 (a) of the 1921 Act all provide that the basis for determining the gain from the sale of property acquired after Feb. 28, 1913, shall be the cost of such property. Subsection (b) of the same sections provide that in case of property acquired before March 1, 1913, the basis shall be its cost or fair market value as of March 1, 1913, whichever is greater.

The construction for which we contend is that adopted and consistently followed by the Treasury Department. See Regulations 74, promulgated under the Act of 1928, Articles 991 and 992; and I. T. 2444, C. B. VII–2, p. 63. (Pp. 35–38, *infra*.)

The question involved in the instant case has been passed upon by no court except the District Court in the instant case.

II

THERE IS NO ROOM FOR DOUBT AS TO THE CONSTITUTIONALITY OF SECTIONS 111, 113, AND 204 OF THE ACT AS CONSTRUED BY THE TREASURY DEPARTMENT

The argument of the taxpayer that these provisions, so construed, are unconstitutional rests on the assumption that a tax upon the entire gain, including that part of the profit which represented an increase in value prior to 1928 is, in part at least, a tax upon capital. This case concerns only sales which were made after the effective date of the Act of 1928, i. e., January 1, 1928. Although that Act was not approved until May 29, 1928, the taxpayer has conceded that Congress could fix as the basis for determining gain the fair market value as of December 31, 1927.[2]

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[2] This concession is, of course, required by decisions of this Court in somewhat analogous cases supporting retroactive tax legislation. *Cooper* v. *United States*, 280 U. S. 409. Cf. *Milliken* v. *United States*, 283 U. S. 15; *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 20. (For a list of taxing statutes which were retroactive in effect, see footnote 1 in the dissenting opinion in *Untermyer* v. *Anderson*, 276 U. S. 440, 447.)

We fail to see any ground for distinction between the period from March 1, 1913, to January 1, 1928, and the period from January 1, 1928, to May 29, 1928. If, as to sales made in 1928, Congress could include the gains accruing during the latter period, what prevented it from including the gains accruing during the earlier period? There was no change in the Constitution during that time.

If an income tax Act may be made effective on a date more than a year before its passage (as was the case in the Revenue Act of 1918, approved on February 24, 1919, 40 Stat. 1057 [3]), it is obvious that no constitutional right can depend upon the effective date of such an Act, at least if that date does not antedate March 1, 1913, the effective date of the Sixteenth Amendment.

The decisions of this Court, we submit, make it clear that there is no room here for any constitutional objection. It is, of course, well settled that gains on the sales of securities may be subjected to income tax, under the Sixteenth Amendment. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *Eldorado Coal Co.* v. *Mager*, 255 U. S. 522; *Goodrich* v. *Edwards*, 255 U. S. 527; *Walsh* v. *Brewster*, 255 U. S. 536. See also *Willcuts* v. *Bunn*, 282 U. S. 216; *Cooper* v. *United States*, 280 U. S. 409; *Lucas* v. *Alexander*, 279 U. S. 573; *Taft* v. *Bowers*, 278 U. S. 470. Although attacks have been made upon

[3] See *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 379.

the constitutionality of the tax on gains on sales of securities on many grounds, and it is obvious that in many of the cases cited the gain taxed included accretions in value prior to the effective date of the applicable Act,[4] apparently it has never occurred to anyone except those now attacking the 1928 Act, that the contention here made was worth making. We have been able to find no discussion of the point by this Court or any other court (except in the instant case), although the practice under every tax Act, beginning with the Revenue Act of 1916, has been to include in gains all increase in value since

[4] This definitely appears of record in *Merchants' L. & T. Co.* v. *Smietanka*, *supra*, 255 U. S. 509. The declaration filed in the District Court alleged that the value of certain stock which was sold in February, 1917, for $1,280,996.64 was worth $561,798 on March 1, 1913, and $714,150 on January 1, 1916, and $1,263,567.50 on January 1, 1917. The declaration also averred that the tax paid included the entire gain over the March 1, 1913, value, and "that said appreciation in money value of said capital assets did not wholly or in part or proportion thereof constitute income, and was not subject to tax as income within the meaning of the Sixteenth Amendment." (No. 608, Oct. Term 1920, R. 6-7, 10.) The District Court sustained a general demurrer to the declaration, and its judgment was affirmed by this Court. The brief filed here in behalf of the taxpayer indicates that the only constitutional point which was made was that no gain whatever on the sale of the property involved could be taxed. But the taxpayer did contend that the Act in question should not be construed "to tax as income for the year of conversion the total increase in the value of capital assets accruing over an extended series of years." (Br. pp. 77 *et seq.*)

March 1, 1913, rather than to draw the line at the effective date of the Act.[5]

In many of these cases it seems to have been assumed, at least by this Court, that Congress could tax all of such gain without deduction of that part of it which was attributable to accretions prior to

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[5] Section 10 of the Revenue Act of 1916 (c. 463, 39 Stat. 756, 765), dealing with income tax on corporations, provides that—

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation * * * of property * * * acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained."

The Revenue Act of 1917 (c. 63, 40 Stat. 300) is an amendment of the 1916 Act, and the method of determining taxable income under the prior Act is continued in use except in so far as amended.

In the Revenue Act of 1918 (c. 18, 40 Stat. 1057) the basis for determining gain or loss sustained from the sale or other disposition of property is set forth in Section 202 (a), and is, in the case of property acquired before March 1, 1913, the market value of the property on that date, and in the case of property acquired after that date it is to be the cost or the inventory value, if the inventory is made in accordance with Section 203.

The basis for determining gain in the Revenue Acts of 1921 (Sec. 202, c. 136, 42 Stat. 227, 229), 1924 (Sec. 204, c. 234, 43 Stat. 253, 258), 1926 (Sec. 204, c. 27, 44 Stat. 9, 14), and 1928 (Sec. 113, c. 852, 45 Stat. 791, 818) is the cost, where the property was acquired after March 1, 1913, or, if the property was acquired before that time, it is cost or market value as of March 1, 1913, whichever is greater.

the effective date of the applicable act. See, for example, *Goodrich* v. *Edwards, supra,* 255 U. S. 527, 533–534; *Taft* v. *Bowers, supra,* 278 U. S. 470, 479. And in *Eisner* v. *Macomber,* 252 U. S. 189, 212, the Court in passing upon the constitutionality of the tax on stock dividends in the Act of 1916 said:

> It is said that a stockholder may sell the new shares acquired in the stock dividend; and so he may, if he can find a buyer. It is equally true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income, and *so far as it may have arisen since the Sixteenth Amendment* is taxable by Congress without apportionment. The same would be true were he to sell some of his original shares at a profit. (Italics ours.)

(We are not considering accretions attributable to the period before March 1, 1913, the effective date of the Sixteenth Amendment, because the Commissioner has not asserted the right to make the basis less than the value on that date. Cf. *Lucas* v. *Alexander, supra,* 279 U. S. 573, 577.)

This Court has held that a donee has no ground for objecting to the payment of a tax on a gain which includes accretions on securities attributable to a period before the securities were given to him (*Taft* v. *Bowers, supra*), or to the payment of a tax on a sale made before the passage, but after the effective date, of the taxing Act (*Cooper* v. *United States, supra*). The taxpayer here has less reason

to complain that the tax imposed deprived it of property without due process of law than had the taxpayers in those cases.

The cases cited by the District Court as supporting the taxpayer's view, *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, and *Hays* v. *Gauley Mt. Coal Co.*, 247 U. S. 189, seem to us not to bear upon the point. They involve merely the construction of the Corporation Excise Tax Act of 1909.

Other cases which are relied upon by counsel for the taxpayer, such as *Lynch* v. *Turrish*, 247 U. S. 221, and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, arose under the Tariff Act of 1913, the first income tax Act. They hold merely that under that Act gains accruing prior to March 1, 1913, the effective date both of the Act and the Amendment, were not taxable.

None of these cases holds that Congress can not, by an Act passed after the effective date of the Sixteenth Amendment, require the inclusion in gross income of all gains which have accrued since that date.

Certain
~~The~~ statements in the certificate of the Circuit Court of Appeals and the opinion of the District Court indicate that these courts felt that possibly the constitutionality of the provisions of the 1928 Act are affected by the fact that during the period from 1921 through 1927 gains on sales of property

made by stock fire insurance companies were not taxed, although such gains of practically all other corporations were.*

We submit that it is clear that the exemption thus extended for a time is unimportant. The company was chargeable with knowledge that Congress had the power to impose such a tax at any time, and its mere failure to do so during the years 1921 through 1927 invested the company with no additional constitutional rights as to sales in future years. Obviously the failure of Congress to include in gross income the gains from sales made during certain years did not affect the nature of

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* The provisions applicable to stock fire insurance companies which operated to exclude gains on sales from gross income are those of Section 246 (b) (I) in each of the following Revenue Acts: 1921 (c. 136, 42 Stat. 227); 1924 (c. 234, 43 Stat. 253); and 1926 (c. 26, 44 Stat. 9).

This was a departure from the scheme of previous Acts, for the Revenue Acts of 1913, 1916, 1917, and 1918 taxed such companies in the same manner as other corporations. See Section II G (a), Tariff Act of 1913 (c. 16, 38 Stat. 114, 172); Section 10, Revenue Act of 1916 (c. 463, 39 Stat. 756, 765); Sections 200 and 201, Revenue Act of 1917 (c. 63, 40 Stat. 300, 302); Sections 1 and 230 (a), Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1075). Thus the provisions of those Acts requiring the inclusion in gross income of gains derived from the sale or other disposition of property were applicable to insurance companies. See Section II B, Tariff Act of 1913; Section 2 (a), Revenue Act of 1916; Section 1200, Revenue Act of 1917; Section 213 (a), Revenue Act of 1918.

The provisions in the later Acts operating to tax corporations generally on gains of sales of securities are Sections 213 and 233 of each of the following Revenue Acts: 1921, 1924, and 1926.

gains from sales made in later years. Nor could such a suspension of action by Congress limit its power in later years. The Act of 1928 does not purport to tax any sales made prior to 1928 or to apply to the sales of stock fire insurance companies any different rules than those which are applied to similar sales of other corporations.

No question of retroactivity is involved, and we know of no case holding that there must be continuity of taxation in order that Congress may preserve the power to tax. The decision in *Merchants L. & T. Co.* v. *Smietanka, supra,* 255 U. S. 509, indicates the contrary, although the point seems not to have been raised.

CONCLUSION

The question certified in this case should be answered in the negative. The basis to be used in this case is that provided in Section 113 of the Revenue Act of 1928.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
Special Assistants to the Attorney General.
WILLIAM H. RILEY, JR.,
Attorney.

FEBRUARY, 1932.

APPENDIX A

STATUTES

The pertinent provisions and headings of the Revenue Act of 1928 (c. 852, 45 Stat. 791, 795, 797, 811, 815, 816, 818, 842, 844, 845) are as follows:

TITLE I—INCOME TAX

SUBTITLE A—INTRODUCTORY PROVISIONS

SEC. 1. APPLICATION OF TITLE.

The provisions of this title shall apply only to the taxable year 1928 and succeeding taxable years. Income, war-profits, and excess-profits taxes for taxable years preceding the taxable year 1928 shall not be affected by the provisions of this title, but shall remain subject to the applicable provisions of prior revenue Acts, except as such provisions are modified by Titles III, IV, and V of this Act or by legislation enacted subsequent to this Act. (U. S. C., Sup. V, Title 26, Sec. 2001.)

SEC. 3. CLASSIFICATION OF PROVISIONS.

The provisions of this title are herein classified and designated as—

Subtitle A—Introductory provisions,

Subtitle B—General provisions, divided into Parts and sections,

Subtitle C—Supplemental provisions, divided into Supplements and sections. (U. S. C., Sup. V, Title 26, Sec. 2003.)

SEC. 4. SPECIAL CLASSES OF TAXPAYERS.

The application to the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof,—Supplement E.

(b) Members of partnerships,—Supplement F.

(c) Insurance companies, — Supplement G.

(d) Nonresident alien individuals,—Supplement H.

(e) Foreign corporations,—Supplement I.

(f) Individual citizens of any possession of the United States who are not otherwise citizens of the United States and who are not residents of the United States,—Supplement J.

(g) Individual citizens of the United States or domestic corporations, satisfying the conditions of section 251 by reason of deriving a large portion of their gross income from sources within a possession of the United States,—Supplement J.

(h) China Trade Act corporations,—Supplement K. (U. S. C., Sup. V, Title 26, Sec. 2004.)

SUBTITLE B—GENERAL PROVISIONS

* * * * *

Part II—Computation of Net Income

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement B—Computation of Net Income

[Supplementary to Subtitle B, Part II]

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(*a*) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(*d*) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this *title* shall be determined under the provisions of section 112. (Italics supplied.) (U. S. C., Sup. V, Title 26, Sec. 2111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(*a*) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized * * *. (U. S. C., Sup. V, Title 26, Sec. 2112.)

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(*a*) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of

property acquired after February 28, 1913, shall be the cost of such property; * * * [With exceptions not here material.]

(*b*) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date. (U. S. C., Sup. V, Title 26, Sec. 2113.)

Supplement G—Insurance Companies

* * * * *

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(*a*) *Imposition of tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income;

(2) In the case of such a foreign insurance company, 12 per centum of its net income from sources within the United States.

(*b*) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property;

(2) NET INCOME.—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

(3) INVESTMENT INCOME.—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) UNDERWRITING INCOME.—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED.—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on out-

standing business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) LOSSES INCURRED.—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) EXPENSES INCURRED.—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23(a);

(2) All interest as provided in section 23(b);

(3) Taxes as provided in section 23(c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23(p);

(8) The amount of interest earned during the taxable year which under section 22(b)(4) is exempt from taxation under this title, and the amount of interest allowed as a credit under section 26;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23(k);

(10) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by this section shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(*d*) *Deductions of foreign corporations.*—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I.

(*e*) *Double deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

APPENDIX B

Regulations and Rulings of the Treasury Department

Regulation 74, promulgated under the Revenue Act of 1928 by the Acting Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, contained the following (pp. 269–270):

> Art. 991. *Tax on insurance companies other than life or mutual.*—For the calendar year 1928 and subsequent years all insurance companies (other than life or mutual companies) are subject to the tax imposed by section 204. Mutual insurance companies (other than life) remain subject to the tax imposed by section 13. The term "insurance companies" as used in this article and in articles 992 and 993 means only those companies subject to the tax imposed by section 204. The rate of the tax imposed by section 204 is 12 per cent, and the net income upon which the tax is imposed, as defined in section 204, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 117 (net losses) but not of section 101 (capital gains and losses). All provisions of the Act and of these regulations not inconsistent with the specific provisions of section 204 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. Since section 204 pro-

vides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 204 will be for the taxable year ending December 31, 1928.

ART. 992. *Gross income of insurance companies other than life or mutual.*—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from sale or other disposition of property. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, gross increase due to adjustments in book value of capital assets, and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Act will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits, are ignored. Gain or loss from agency balances and bills receiv-

able not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts, or, having been previously charged off, are recovered during the taxable year.

The following is a ruling of the Income Tax Unit of the Bureau of Internal Revenue (I. T. 2444; C. B. VII–2, p. 63):

> The question is presented relative to the basis to be used in computing gain or loss resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) under section 204 of the Revenue Act of 1928.
>
> In defining the term "gross income," clause (A) of section 204 (b)1 of the Revenue Act of 1928, relative to investment income and underwriting income, is substantially the same as section 246 (b)1 of the Revenue Act of 1926. Section 204 (b)1 of the Revenue Act of 1928, however, contains a new provision, clause (B), which provides that gross income also includes "gain during the taxable year from the sale or other disposition of the property." Section 204 (c)5 is also new and provides that "Losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies. Inasmuch as these provisions in the Revenue Act of 1928 are new, the question is presented as to whether, in the case of property owned by such taxpayers on January 1, 1928, the basis to be used in computing gain or loss is the fair market value of the property on

that date or whether the basis is that provided by section 113 of the Act.

Section 111 (a) of the Revenue Act of 1928, relating to the computation of gain or loss from the sale or other disposition of property, provides as follows:

"Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized."

Inasmuch as this is a general provision for the determination of gain or loss, it is applicable to all sales or other dispositions of property as a result of which a taxable gain or deductible loss is recognized for income tax purposes. Such being the case, it is applicable to the sale or other disposition of property by insurance companies under section 204. The basis to be used in computing gain or loss resulting from the sale or other disposition of property by such insurance companies on or after January 1, 1928, under the provisions of section 204 of the Act is, therefore, the cost, the fair market value as of March 1, 1913, or other basis as provided by section 113 of the Act, and not the fair market value as of January 1, 1928, the effective date of the Income Tax Act of 1928.

APPENDIX C

Legislative History of the Provisions of Section 204 (b) (1) (B) of the Revenue Act of 1928

In the report of the Joint Committee on Internal Revenue Taxation, dated December 22, 1927 (Document No. 139, 70th Congress, 1st Session), the chairman of the Committee in discussing simplification of revenue legislation, stated (page 2):

> * * * A recommendation was approved that the act be rearranged so as to collect at one place (preferably near the beginning of the act) the general provisions which apply to the cases of practically all taxpayers, and to carry to appropriate places at subsequent parts of the act the special provisions which apply only to the occasional transaction or to particular classes of tax cases. The result of such a rearrangement is that the ordinary taxpayer is likely to find in the first few pages of the act all of the statute law of interest to him. There were also recommendations for the use of headings to sections and subsections, for improved forms of cross-reference and for the use of certain typographical improvements which make the finding of a particular provision less difficult than under prior laws. Finally, it was recommended that the 1926 Act be retained in force so far as it relates to the estate tax and the miscellaneous taxes, thus avoiding the repetition of those provisions in the new act. A similar recommendation was made with respect to the administrative provi-

sions which relate solely to taxes imposed by the Act of 1926 and prior laws. The result is to make the new act an income tax act which is practically free of the complicated provisions relating to prior years, most of the tax cases of which are closed out at the present time. * * *

Under the heading "Uncompleted Work—Investigation," there is the following:

(*c*) *Insurance.*—There are many special provisions in the Revenue Act relating to insurance companies. It appears that but little attention has been given to these provisions since the Revenue Act of 1921 was enacted. One of the specific points being investigated on this subject is the effect of exempting such companies from all tax on capital gains.

* * * * *

(*f*) *Gain or loss.*—The provisions relating to the recommendation of gain or loss from sales or exchanges have presented difficult questions. A report on this subject that will show the operation and effect of the present statute has been undertaken.

In the Appendix of that report there is a summary of recommendations of the Joint Committee. Under the heading of "Simplification" is the following statement (p. 7):

The arrangement of sections in the act is not satisfactory. A taxpayer can not find at any one place, a simple statement of the basic principles of the income tax. A complete rearrangement, published in Volume II of this report, is recommended, a principal feature of which is that all provisions of general interest to the great body of taxpayers

are collected in sixteen pages at the beginning of the act.

In its present form the act embraces several complicated provisions relating solely to taxes under earlier laws. The Bureau of Internal Revenue is almost current with its work and these provisions no longer have the importance they once had. They should be omitted from future revenue acts. Accordingly, it is recommended that the Revenue Act of 1926 be continued in force for the adjustment of old cases and that the sections above referred to be entirely omitted from the next Revenue Act. * * *

The introductory paragraph of the Report of the Committee on Ways and Means of the House of Representatives, dated December 7, 1927 (House Report No. 2, 70th Congress, 1st Session), was as follows:

> The Committee on Ways and Means, to which was referred the bill (H. R. 1) to reduce and equalize taxation, provide revenue, and for other purposes, having had the same under consideration, reports it back to the House without amendment and recommends that the bill do pass.

The following statements were also in this Report (p. 2):

> The present law contained a provision for the creation of a Joint Committee of the House and Senate on Internal Revenue Taxation. One of the duties of this Committee was to consider measures for the simplification of the Revenue Act. * * * Not all the recommendations of the Joint Committee were approved—in fact, your Committee did not have time to properly consider

all of them. But the greater part of the recommendations of the Joint Committee were adopted and are part of the bill, among which is the rearrangement of the law.

On page 11 of this Report under the heading of "Structure of New Bill as Compared With Prior Revenue Acts," it was said:

> The bill in one respect differs materially from the Revenue Acts of 1918, 1921, 1924, and 1926. Each of those Acts reenacted all the provisions of the preceding Act, with such changes and omissions as the policy of Congress dictated, and then repealed the preceding Act, with certain exceptions.

On page 12 of the same Report, under the heading of "Rearrangement of Income Tax Title," is the following statement:

> The bill embodies a proposed new arrangement for the income tax title. The basis for the arrangement is the distribution of the provisions by two classifications: General Provisions and Supplemental Provisions. There are a few Introductory Provisions.
>
> The General Provisions are those which apply to the ordinary transactions of the ordinary classes of taxpayers. It is believed that approximately 80 per centum of the taxpayers who file returns under the new Act will find in the General Provisions practically all the income tax statute law of interest to them. The General Provisions are divided into Parts.
>
> The Supplemental Provisions comprise all provisions of the income tax title other than the General Provisions and the Introductory Provisions. In the main, the Supplemental Provisions are those which apply only to extraordinary classes of taxpayers or which

apply only to the extraordinary transactions of ordinary classes of taxpayers. The Supplemental Provisions are divided into Supplements.

The Committee on Finance of the Senate, to which was referred from the House bill (H. R. 1), which subsequently became the Revenue Act of 1928, reported the bill favorably to the Senate with certain amendments. (Senate Report No. 960, May 1, 1928, 70th Congress, 1st Session.) On page 17 of this Report, under the heading, "Structure of New Bill as Compared with Prior Revenue Acts," the discussion of the changed form of the bill is substantially the same as that under the same heading of the House Report on page 11. Likewise the discussion on page 18 of the Senate Report, under the heading "Rearrangement of Income Tax Title," is the same as that under the same heading in the House Report on page 12.

The Revenue Bill of 1928 (H. R. 1, 70th Congress, 1st Session) as passed by the House and as introduced in the Senate did not tax the gain derived from the sale or other disposition of property in the case of insurance companies generally.

It was while the Bill was before the Senate for consideration that Senator Reed of Pennsylvania, during the debate and from the floor, introduced Senate Amendments 115, 116, 117, and 118, proposing to tax the gains derived during the taxable year by insurance companies (other than life or mutual insurance companies) from the sale or other disposition of property, with corresponding deductions for losses sustained during the taxable year in the sale or other disposition of such property.

Section 204 (b) as passed by the House, with the Amendments of Senator Reed added in italics, reads as follows:

(b) *Definition of Income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.*—"Gross Income" means [115] *the sum of* (*A*) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, [116] *and* (B) *gain during the taxable year from the sale or other disposition of property;*

(2) *Net Income.*—"Net Income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

* * * * * *

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * *

(4) Losses incurred [117] *as defined in subsection* (b) (6) *of this section;*

[118] (5) *Losses sustained during the taxable year from the sale or other disposition of property.*

When Senator Reed introduced these Amendments on May 21, 1928, the following colloquy occurred (Cong. Record, Vol. 69, Part 9, page 9337):

Mr. REED of Pennsylvania. Mr. President, I offer the amendment which I send to the desk.

The VICE PRESIDENT. The amendment will be stated.

The CHIEF CLERK. On page 146, at the end of line 10, insert "the sum of (A)", and in line 16, after "Commissioners," insert a comma and the following: "and (B) gain during the taxable year from the sale or other disposition of property."

On page 149, line 1, after "incurred," insert "as defined in subsection (b) (6) of this section" and after line 1, insert a new paragraph to read as follows:

"(5) Losses sustained during the taxable year from the sale or other disposition of property.",

On page 149, renumber paragraph (6) to (9), inclusive.

Mr. REED of Pennsylvania. Mr. President, there are three amendments that go together. They are all part of the same idea. In brief, they are this:

At the present time, a mutual fire-insurance company or a mutual casualty company or a mutual marine-insurance company—not life insurance; this has nothing to do with life insurance—any mutual company has to pay a tax on the profits that it makes in dealing in stocks or bonds or real estate; but, as the law now stands, a fire-insurance company which has capital stock, and is owned by stockholders instead of policyholders, can deal in stocks and make a profit on the purchase and sale of them and pay no tax whatsoever on that profit. The same thing is true of a stock casualty company or a stock marine-insurance company.

I can imagine reasons why Congress would want to be more lenient to mutuals than to stock companies. I can not imagine,

nor has anyone suggested, any reason why we should be more lenient with companies that are owned by stockholders than with companies that are owned by policyholders.

Mr. NORRIS. Mr. President, may I make an inquiry of the Senator?

Mr. REED of Pennsylvania. Certainly.

Mr. NORRIS. Is it right, then, to say that under existing law, without the Senator's amendment, we are more lenient to stock companies than to mutual companies?

Mr. REED of Pennsylvania. Absolutely.

Mr. NORRIS. If the amendment is agreed to we put them on the same basis?

Mr. REED of Pennsylvania. We put them on the same basis.

I am not going to speak long about this matter, but let us have no doubt about it. As I said in the Committee of the Whole, if any rich man in America wants to avoid taxes to-day, the finest way that I know of to do it is to buy control of a little stock fire-insurance company and use that as his holding company, because he may gamble in bonds or stocks or lands as he pleases, and he does so absolutely tax free. Outside of the life-insurance companies—and the Senate settled that, so I am not going to discuss them—there is no other business corporation in America that can enjoy such profits without paying any tax upon them. I can see no defense for it. I think the only explanation for it is that it was an accident of legislation that Congress never fully understood.

The VICE PRESIDENT. Without objection, the vote will be taken on the amendments en bloc. The question is on the amendments of the Senator from Pennsylvania. [Putting the question.] The amendments are agreed to.

The Bill, with its Amendments, went to Conference, and the statement of the Managers on the part of the House relative to the Amendments in question (Conference Report No. 1882, page 18) reads as follows:

> Amendments Nos. 115, 116, 117, and 118: In the case of an insurance company (other than a life or mutual) under existing law and under the House Bill the gain or loss from the sale or other disposition of property (including securities) is not recognized. The effect of these amendments is to recognize such gains and losses; and the House recedes.

U. S. GOVERNMENT PRINTING OFFICE: 1932

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FEB 2

IN THE

Supreme Court of the United States

No. 548. OCTOBER TERM, 1931.

JOSEPH S. MacLAUGHLIN, Collector of Internal Revenue For the First District of Pennsylvania,
Appellant,

v.

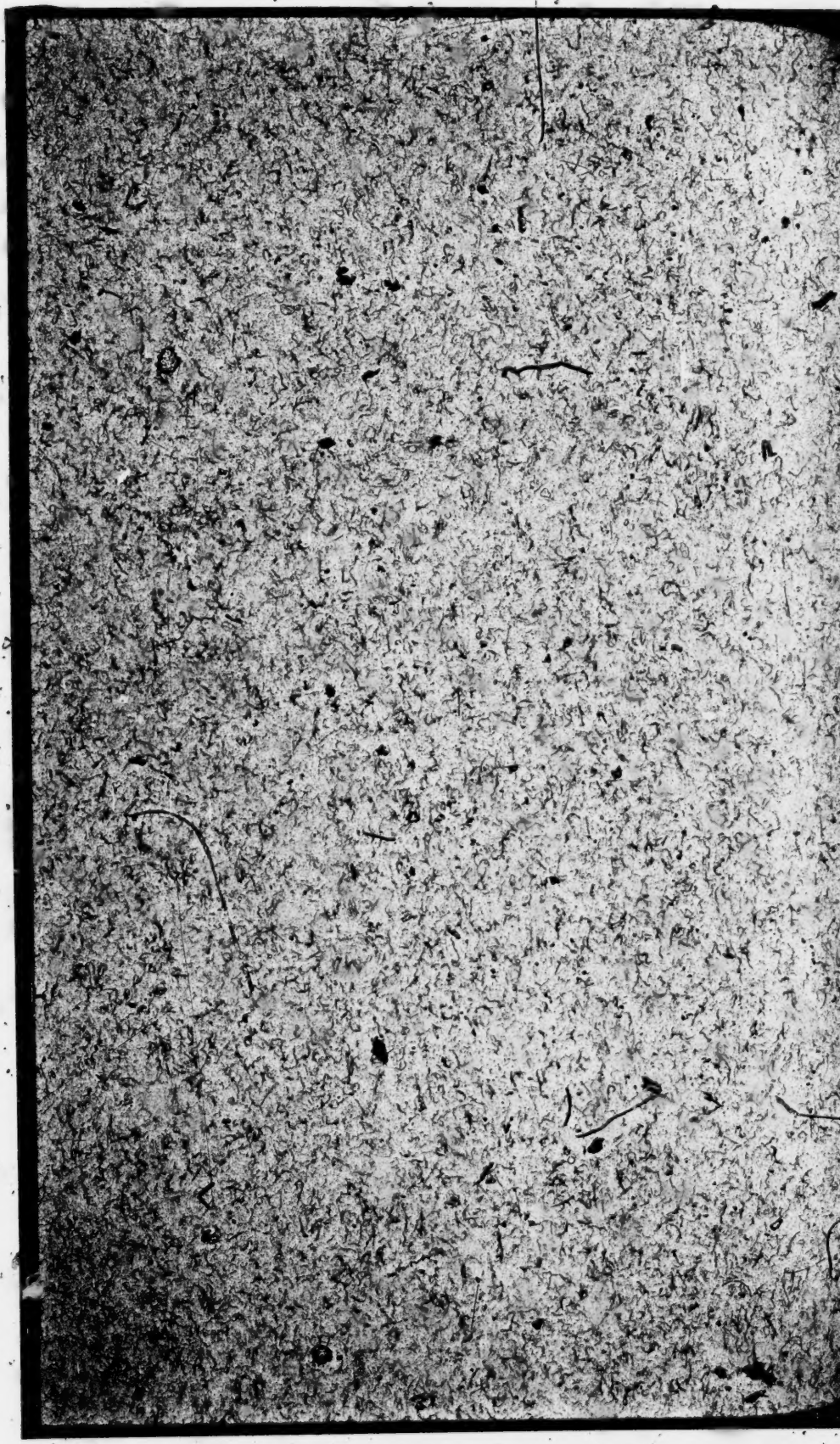
ALLIANCE INSURANCE COMPANY OF PHILADELPHIA,
Appellee.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, APPELLEE.

EDWARD M. BIDDLE,
1600 Arch Street,
Philadelphia, Pa.

ROBERT C. WALKER,
ROBERT T. McCRACKEN,
1421 Chestnut Street,
Philadelphia, Pa.
Attorneys for Appellee.



INDEX.

		PAGE
I.	THE OPINION OF THE COURT BELOW	1
II.	JURISDICTION	2
III.	QUESTION CERTIFIED	2
IV.	STATEMENT OF THE CASE	3
V.	SUMMARY OF THE ARGUMENT	3
VI.	ARGUMENT	5
	Statement of Appellee's Contention	8
	The power of Congress under the Sixteenth Amendment is only to lay a tax on income.	9
	The proper interpretation of Section 204 (b) (1) Clause (B) of the Revenue Act of 1928 is that the basis for determining gain from the sale or other disposition of property acquired before January 1, 1928 is the value of such property as of December 31, 1927	10
	The meaning of the word "income" in income tax acts is definitely settled by the decisions of this Court	30
	Any increased value that accrued before January 1, 1928, the effective date of the new clause in question, is capital and not income	31
	A reasonable construction should be adopted, which would uphold the Act	34
	Comments on Authorities relied on by Appellant	35
	Conclusion	44

AUTHORITIES AND STATUTES RELIED UPON.

Cases.

PAGE

Blodgett *v.* Holden, 275 U. S. 142 27

Bowers, Collector of Internal Revenue *v.* Kerbaugh Empire Co., 271 U. S. 170 30

Burnet, Commissioner of Internal Revenue *v.* Sanford and Brooks Company, 282 U. S. 359 32

Cooper *v.* United States, 280 U. S. 409 ..... 37, 38

Doyle, Collector of Internal Revenue *v.* Mitchell Brothers Co., 247 U. S. 179 ..... 32, 35, 40

Eisner *v.* Macomber, 252 U. S. 189 ..... 38, 39

Goodrich *v.* Edwards, 255 U. S. 527 36

Gould *v.* Gould, 245 U. S. 151 27

Hays, Collector of Internal Revenue *v.* Gauley Mountain Coal Co., 247 U. S. 189 32

Lynch, Collector of Internal Revenue *v.* Turrish, 247 U. S. 221 32

Merchants Loan & Trust Co. *v.* Smietanka, 255 U. S. 509 ..... 30, 42

Nichols *v.* Coolidge, 274 U. S. 531 ..... 27, 35

Panama Railroad Co. *v.* Johnson, 264 U. S. 375 35

Reinecke, Collector of Internal Revenue *v.* Northern Trust Company, 278 U. S. 339 34

Smietanka *v.* First Trust and Savings Bank, 257 U. S. 602 42

Southern Pacific Co. *v.* Lowe, 247 U. S. 330 ..9, 33, 34, 35

Taft *v.* Bowers, 278 U. S. 470 37

United States *v.* Jin Fuey Moy, 241 U. S. 394 34

Untermeyer *v.* Anderson, 276 U. S. 440 27

Statutes.

PAGE

Tariff Act of 1913, 38 Stat. 114, 173 ..... 5, 31, 33
Revenue Act of 1916, 39 Stat. 756 ..... 5, 31, 39
Revenue Act of 1917, 40 Stat. 300 ..... 5, 30, 31
Revenue Act of 1918, 40 Stat. 1057 5
Revenue Act of 1921, 42 Stat. 227 ... 5, 23, 30, 31, 38, 43
Revenue Act of 1924, 43 Stat. 253 ..... 5, 23, 31, 43
Revenue Act of 1926, 44 Stat. 9 ..... 5, 23, 31, 43
Revenue Act of 1928, 45 Stat. 791 .... 5, 9, 11, 13, 14, 23, 26, 29, 41, 44

Section 1 (26 U. S. C. A. Section 2001) 12
Section 4 (26 U. S. C. A. Section 2004) 10, 11, 21
Section 13 (26 U. S. C. A. Section 2013) ... 5, 13, 14, 15
Section 22 (26 U. S. C. A. Section 2022) 18, 22
Section 23 (26 U. S. C. A. Section 2023) ... 16, 18, 19, 20, 22
Section 65 (26 U. S. C. A. Section 2065) 12
Section 111 (26 U. S. C. A. Section 2111) 22
Section 112 (26 U. S. C. A. Section 2112) 22
Section 113 (26 U. S. C. A. Section 2113) . 8, 10, 11, 13, 19, 20, 22, 28, 29, 44
Section 117 (26 U. S. C. A. Section 2117) 41
Section 119 (26 U. S. C. A. Section 2119) 40, 41
Section 201 (26 U. S. C. A. Section 2201) ... 14, 15, 17, 40, 41, 43
Section 202 (26 U. S. C. A. Section 2202) 17, 43
Section 203 (26 U. S. C. A. Section 2203) 17, 43
Section 204 (26 U. S. C. A. Section 2204) .. 3, 4, 5, 7, 8, 10, 11, 14, 15, 17, 18, 19, 20, 21, 22, 25, 26, 27, 29, 31, 35, 40, 43, 44
Section 205 (26 U. S. C. A. Section 2205) 17, 21, 22, 41
Section 206 (26 U. S. C. A. Section 2206) 17, 21, 22
Section 207 (26 U. S. C. A. Section 2207) 17, 21, 22, 41
Section 208 (26 U. S. C. A. Section 2208) ... 14, 15, 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931. No. 548.

Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania,
Appellant,

v.

Alliance Insurance Company of Philadelphia,
Appellee.

BRIEF FOR ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, APPELLEE.

I. THE OPINION OF THE COURT BELOW.

The opinion of the District Court for the Eastern District of Pennsylvania, by Judge Kirkpatrick, is reported in 49 Federal Reporter (2d Series) 361.

The United States Circuit Court of Appeals for the Third Circuit, without deciding the case, has certified to this Court the question involved.

The opinion of the District Court, not being included in the Certificate, is set forth in full as Appendix A at the end of Appellant's brief filed in this Court in the companion case of The Insurance Company of the State of Pennsylvania *v.* MacLaughlin, No. 547, October Term, 1931.

II. JURISDICTION.

The question here presented has been certified to the Supreme Court of the United States by the Circuit Court of Appeals for the Third Circuit under the authority of Section 239 of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. Code, Title 28, Section 346).

III. QUESTION CERTIFIED.

Under the Revenue Act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing "gain during the taxable year from the sale or other disposition of property," acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the Act? (Cert., p. 3.)

IV. STATEMENT OF THE CASE.

A full statement of the case as certified by the Circuit Court of Appeals for the Third Circuit has been set forth in Appellant's brief and in the interest of brevity is not repeated at this point.

V. SUMMARY OF THE ARGUMENT.

From March 1, 1913, until January 1, 1921, gain which had accrued subsequent to the former date and had been realized in the taxable year by insurance companies was subject to income tax as in the case of all other corporations. Such gain, however, was omitted from the definition of gross income of life insurance companies and of insurance companies (other than life or mutual) in the taxing Acts from January 1, 1921, until January 1, 1928, the effective date of the Revenue Act of 1928. A change was then effected in respect to insurance companies (other than life or mutual) by an amendment to section 204 of the Act which provided that gross income should include "gain during the taxable year from the sale or other disposition of property." This amendment was suggested by Senator Reed of Pennsylvania in order that insurance companies (other than life or mutual) might be "put on the same basis" in this respect with mutual companies.

Section 204 of the Revenue Act of 1928 which governs the taxation of insurance companies (other than life or mutual) is self-sustaining insofar as the matters are concerned which it purports to cover,

except where there are express cross-references. There is no such cross-reference in Section 204 (b) (1) (B), which is the clause here under consideration. The Supplement is also silent as to how such gain shall be computed.

There is entirely absent from the Revenue Act of 1928 and from the legislative history of the present amendment any evidence of an intention on the part of Congress to penalize this type of insurance company by subjecting it to an income tax upon gain realized from the sale or other disposition of property during the taxable year, which had accrued five or ten years or even longer before the effective date of the Act on January 1, 1928. Even if such an intention had been clearly and unequivocally expressed in the Act, which it is not, it would have exceeded the power of Congress to levy such a tax for the reasons that to do so would tax capital under the guise of income and would levy a tax which by its terms is so arbitrary and capricious that its enforcement would amount to the deprivation of property without due process of law within the inhibition of the Fifth Amendment.

Under these circumstances, therefore, it is submitted that the reasonable construction to be accorded Section 204 (b) (1) (B) is that it subjects to taxation as income only such portion of the gain realized by insurance companies other than life or mutual during the taxable year as had accrued subsequent to January 1, 1928, the effective date of the Revenue Act of 1928.

VI. ARGUMENT.

The Revenue Act of 1913 and the subsequent Acts of 1916, 1917 and 1918 taxed all insurance companies in the same manner as corporations generally. Under these Acts gain which accrued subsequent to March 1, 1913, and was realized during the taxable year from the sale or other disposition of property was taxable as income. Under the Revenue Act of 1921, however, gain by insurance companies (other than mutual) from the sale or other disposition of property was no longer subject to tax, nor were said companies permitted to deduct losses sustained in like manner. The Revenue Acts of 1924 and 1926 re-enacted substantially the provisions of the Act of 1921 in this respect. Thus, from January 1, 1921, until January 1, 1928, insurance companies (other than mutual) were not subject to income tax upon gain derived from the sale or other disposition of property.

The Revenue Act of 1928, approved May 29, 1928, became effective as of January 1, 1928.

Section 13 of that Act imposes a tax of 12% upon the net income of corporations generally. Supplement G, which is composed of Sections 201 to 208, inclusive, dealing with insurance companies, provides by Section 204 (26 U. S. C. A. sec. 2204) as follows:

> "(*a*) In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

"(1) In the case of such a domestic insurance company 12% of its net income; * * *.

"(*b*) Definition of income, etc. In the case of an insurance company subject to the tax imposed by this section—

"(1) Gross income.—'Gross income' means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property.

"(*c*) Deductions allowed.—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

* * * * * * *

"(5) Losses sustained during the taxable year from the sale or other disposition of property; * * *."

The foregoing clauses, (b) (1) clause (B) and (c) (5), which provide for the inclusion in the definition of "gross income" of "gain during the taxable year from the sale or other disposition of property" and that "losses sustained during the taxable year from the sale or other disposition of property" shall be allowed as deductions in computing the net income of such insurance companies, are new.

The question of the proper construction of these new clauses of the Revenue Act of 1928 was first stated by the Bureau of Internal Revenue of the Treasury Department in Internal Revenue Bulletin Volume 7 No. 51, December 17, 1928, as follows:

"The question is presented relative to the basis to be used in computing gain or loss resulting from the sale or other disposition of property by insurance companies (other than life or mutual insurance companies) under section 204 of the Revenue Act of 1928.

"In defining the term 'gross income', clause (A) of section 204 (b) 1 of the Revenue Act of 1928, relative to investment income and underwriting income, is substantially the same as section 246 (b) 1 of the Revenue Act of 1926.

"Section 204 (b) 1 of the Revenue Act of 1928, however, contains a new provision, clause (B) which provides that gross income also includes 'gain during the taxable year from the sale or other disposition of property.' Section 204 (c) 5 is also new and provides that 'Losses sustained during the taxable year from the sale or other disposition of property' shall be allowed as deductions in computing the net income of such insurance companies. Inasmuch as these provisions in the Revenue Act of 1928 are new, the question is presented as to whether, in the case of property owned by such taxpayers on January 1, 1928, the basis to be used in computing gain or loss is the fair market value of the property on that date or whether the basis is that provided by section 113 of the Act."

The construction adopted by the Bureau of Internal Revenue was that:

"The basis to be used in computing gain or loss resulting from the sale or other disposition

of property by such insurance companies on or after January 1, 1928, under the provisions of Section 204 of the Act is the cost, the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act, and not the fair market value as of January 1, 1928, the effective date of the Income Tax Act of 1928."

Statement of Appellee's Contention.

The appellee contends that the Bureau of Internal Revenue erred in the foregoing construction and that the proper construction of clause (b) 1 (B) of Section 204 of the Revenue Act of 1928 is that the basis to be used in computing gain resulting from the sale or other disposition during the taxable year 1928 of property acquired before January 1, 1928, by insurance companies (other than life or mutual insurance companies) is the fair market value thereof as of December 31, 1927, instead of the fair market value thereof as of March 1, 1913, or other basis as provided by Section 113 of the Act.

The refund which appellee seeks to recover is the amount of tax paid on alleged gain from the sale of property during the year 1928, in excess of the amount that would have been paid if the gain had been determined on the basis of the value of the property as of December 31, 1927, instead of on the basis of the value thereof as of March 1, 1913, or other basis as provided by Section 113 of the Act; in other words, the amount claimed is the amount of tax paid on value that accrued on capital assets before the effec-

tive date of the new clause during a long period of years, during which insurance companies (other than life or mutual) were not subject to a tax on such gain.

The power of Congress under the Sixteenth Amendment is only to lay a tax on income.

The validity of the Revenue Act of 1928, as the tax under it is not apportioned among the states, is derived from the Sixteenth Amendment. The title of the Sixteenth Amendment is "Income Tax," and the language used in the body of the Amendment states that the power given to Congress is "to lay and to collect taxes on incomes." Therefore to tax capital under the Revenue Act of 1928 is not within the power of Congress.

Under the Sixteenth Amendment for the first time Congress was empowered to tax income from property without apportioning the tax among the states according to population: **Southern Pacific Co. v. Lowe (1917) 247 U. S. 330, 335.** An interpretation of any part of that Act which would result in its taxing capital would render such part unconstitutional and void.

The Sixteenth Amendment is as follows:

"INCOME TAX.

"The congress shall have power to lay and collect taxes on incomes from whatever sources derived, without apportionment among the several states, and without regard to any census of enumeration."

The proper interpretation of Section 204 (b) (1) Clause (B) of the Revenue Act of 1928 is that the basis for determining gain from the sale or other disposition of property acquired before January 1, 1928, is the value of such property as of December 31, 1927.

It is submitted that Section 113, invoked by the Bureau, has no application to the new clause in Section 204 and that the purpose and intention of Congress was that the basis to be used in computing gain by insurance companies (other than life or mutual insurance companies) from the sale or other disposition of property acquired before January 1, 1928, should be the fair market value of the property as of December 31, 1927. Any other conclusion would render the clause unconstitutional and void on the ground that it would result in taxing as income that which is not income but increase of capital, and not subject to a tax as income, and on the further ground that it would levy a tax which by its terms is so arbitrary and capricious that its enforcement would amount to the deprivation of property without due process of law within the inhibition of the Fifth Amendment.

It is provided in Section 4 of the Act that special classes of taxpayers, among whom insurance companies are enumerated, specially dealt with in separate chapters which are designated "Supplements," shall not be subject to the application of provisions in the Act general in their nature, but that the

general provisions shall be subject to the exceptions and additional provisions found in the Supplements dealing with the special classes of taxpayers.

Section 4 provides as follows:

"SPECIAL CLASSES OF TAXPAYERS.

"The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows: * * *

"(c) Insurance companies,—Supplement G."

Section 113 is a part of Supplement B, which is thus subject to the exceptions and additional provisions found in Supplement G, relating to insurance companies, which includes Section 204.

The fact that the effective date of the new clause of Section 204 (providing for the inclusion within gross income of "gain during the taxable year from the sale or other disposition of property") is January 1, 1928, and that the provisions of the Revenue Act of 1928 are expressly made applicable only to the taxable year 1928 and succeeding taxable years make it manifest that gain during the taxable year from the sale or other disposition of property, was intended to be limited to that accruing on or after January 1, 1928, and thus that the clause in question constitutes an exception or additional provision to which Section 113 of the Act is subject, rather than the reverse.

Section 1 of the Act is as follows:

"APPLICATION OF TITLE.

"The provisions of this title (the Income Tax portion of the Revenue Act of 1928) shall apply only to the taxable year 1928 and succeeding taxable years. Income, war-profits and excess-profits taxes for taxable years, preceding the taxable year 1928 shall not be affected by the provisions of this title, but shall remain subject to the applicable provisions of prior revenue Acts, except as such provisions are modified by Titles III, IV, and V of this Act or by legislation enacted subsequent to this Act."

Section 65 is as follows:

"EFFECTIVE DATE OF TITLE.

"This title shall take effect as of January 1, 1928, except that Sections 146 and 151, and this section, shall take effect on the enactment of this Act."

The Act contains a number of general provisions prescribing the rate of tax, what is to be included in gross income, what is to be deducted therefrom in arriving at net income, the various credits to which certain classes of taxpayers are entitled, and the basis for determining gain or loss from the sale or other disposition of property, insofar as the taxation of corporations, partnerships and individuals in general, subject thereto, is concerned, all of whom since 1913 have not only been subject to

income taxes but to a tax on gain from the sale or other disposition of property. The basis for determining the gain or loss of such taxpayers is under Section 113.

In the various income tax acts, including the Revenue Act of 1928, Congress has recognized that because of the very nature of the insurance business it is necessary to treat life insurance companies and insurance companies (other than life or mutual) as special classes of taxpayers separate and distinct from corporations in general. This is necessary because of the difficulty of reflecting the true income of such companies. The practices of all insurance companies are different from those of an industrial corporation. Even the accounting terms have a technical meaning which would not be comprehensible to an expert accountant unless he had specialized in insurance accounting. Life insurance accounting is entirely different in character from that followed by fire insurance companies. Accounting practices of mutual companies are different from those followed by stock companies. To meet this situation, Congress has seen fit not only to segregate insurance companies from other corporations but to distinguish between life companies and companies other than life, and between stock companies and mutual companies, in the income tax laws, including the Revenue Act of 1928.

The tax on corporations in general is imposed by Section 13, but the tax on life insurance companies

and on insurance companies (other than life or mutual) is imposed by Sections 201 and 204 of Supplement G "in lieu of the tax imposed by Section 13 of this title." These words are indicative of the complete severance of these Sections of the Act from the general provisions thereof insofar as the matters covered by these Sections are concerned. It was not necessary for Congress to use the words "in lieu of the tax imposed by Section 13 of this title," the rate of tax under all three sections being identical, namely, 12%. The only possible reason for the use of this phrase was to emphasize the fact that Sections 201 and 204 imposing the tax upon insurance companies other than mutual companies are self-sustaining as to matters covered thereby.

This separate treatment of life insurance companies and insurance companies other than life or mutual is emphasized by the wording of Section 208 (a) of Supplement G dealing with mutual insurance companies other than life. Until the Act of 1928 there had been no separate clauses dealing with this kind of insurance company. Under previous acts a mutual insurance company other than life had simply been taxed under the general clauses covering other corporations. Mutual insurance companies other than life were first specifically mentioned in Section 208 of the Revenue Act of 1928. It is to be noted, however, that the theory upon which this section was drafted is entirely different from that followed in the drafting of the other sections of Supplement G

dealing with life insurance companies and insurance companies other than life or mutual. It is not attempted in Section 208 to set forth a detailed scheme of taxation applying to this type of company. It had evidently been found as a result of administering the income tax laws for fifteen years that mutual insurance companies other than life could with certain slight variations be treated under the general taxing provisions. As already stated, these variations are covered in Section 208 but in each instance this is accomplished by express reference to the general clauses of the Act applying to other corporations. Thus we find that instead of using the phrase "in lieu of the tax imposed by Section 13 of this title" as was done in Sections 201 and 204 applying to insurance companies other than mutual, Section 208 refers back to Section 13 which imposes the tax upon corporations in general, providing that "mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this Section."

The intention to tax mutual insurance companies other than life "in the same manner as other corporations" is also evident from the other provisions of Section 208. Thus it is to be noted that Section 208 does not contain a complete definition of gross income of mutual companies. The definition of gross income set forth in sub-division (b) of Section 208 applies only to mutual *marine* insurance companies

and simply provides that "mutual marine insurance companies shall include in gross income the gross premiums collected and received by them, less amounts paid for reinsurance." Congress was obviously of the opinion that the gross income of mutual insurance companies in general requires no special treatment and can be accurately reflected by the application of the general clauses of the Act defining the gross income of taxpayers generally.

Moreover Section 208 (b) referring to the gross income of mutual marine insurance companies does not even contain a complete definition of gross income of such companies. It merely refers to a particular item which is to be "included" in their gross income.

The same applies to deductions which are provided for under sub-division (c) of Section 208 which provides: "*In addition* to the deductions allowed to corporations by Section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed." Thus the deductions allowed mutual insurance companies in general are to be found in Section 23 as in the case of all other corporations. In addition to such deductions Section 208 sets forth certain additional deductions to which certain types of mutual insurance companies are entitled.

Thus, all through Section 208 it is clearly the intention of Congress that mutual insurance companies other than life shall be taxed "in the same manner as other corporations," and the definitions

of gross income, of the deductions allowed, and of the rate of tax are all to be found in the general sections of the Act which apply to corporations in general. This treatment of mutual companies is in direct contrast to that afforded life insurance companies and insurance companies other than life or mutual under Sections 201 to 207 inclusive, which are obviously intended to be complete as to matters covered thereby.

It is contended by counsel for the Collector that the clauses requiring corporations to file returns, specifying the time for payment of tax, forbidding accumulation of surplus to avoid surtaxes, providing for the taxable period embracing years with different laws, and the other sections referred to on pages 14 to 17 of the Collector's brief, must be applicable to insurance companies (other than life or mutual) "for otherwise the Act would completely fail to provide for appropriate and necessary details as to administrative and many other matters relative to insurance companies." It is admitted that these general provisions of the Act do apply to such insurance companies, for the reason that Section 204 is complete only insofar as it purports to cover the matters specified therein, one of which is "gain during the taxable year from the sale or other disposition of property." Insofar as these matters are concerned, this section is exclusive of the general provisions of the Act except where they are incorporated by express reference. On the other hand,

when we come to matters which the section does not attempt to cover then we turn for guidance to the appropriate general sections.

A separate and complete definition of income, both gross and net, and a separate and complete statement of deductions allowed, as distinguished from the definition of income and a statement of deductions allowed in the case of corporations in general is included in Section 204.

Among other definitions in Section 204 are such phrases as "investment income," "underwriting income," "losses incurred," and "expenses incurred." All of these phrases have well recognized meanings in ordinary corporate accounting, but because of their technical meaning in insurance accounting the drafters of the Income Tax Act of 1928 considered it advisable to specifically define them in order to avoid any misunderstanding on the subject.

Section 204 contains certain references to the general provisions of the Act, in each instance, however, by specific reference. Thus we see that among the deductions allowed are:

> (1) All ordinary and necessary expenses incurred, as provided in Section 23 (a);
>
> (2) All interest as provided in Section 23 (b);
>
> (3) Taxes as provided in Section 23 (c);
>
> (7) The amount received as dividends from corporations, as provided in Section 23 (p);
>
> (8) The amount of interest earned during the taxable year which under Section 22 (b) 4 is

exempt from taxation under this title, and the amount of interest allowed as a credit under Section 26;

(9) A reasonable allowance for the exhaustion, wear and tear, as provided in Section 23 (k).

In other words, wherever it was intended that there should be a cross-reference to the general provisions of the Act, such cross-reference is specifically included in the language of Section 204.

It is to be noted that such cross-references are absent from the clauses here under consideration, namely, the definition of gross income contained in sub-division (b) 1 of Section 204, which provides:

"Gross income means the sum of (A) * * *, and (B) gain during the taxable year from the sale or other disposition of property,"

and the enumeration of deductions allowed, set forth in sub-paragraph (c) of Section 204 which provides that

"In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions: * * * (5) losses sustained during the taxable year from the sale or other disposition of property."

If Congress had intended that such gain and losses should be determined as provided in Section 113 of the Act, it would have been perfectly simple by the addition of a few words to the appropriate

clauses of Section 204 to have indicated its intentions in this regard.

The failure of Congress to do so is emphasized by the fact that such a cross-reference is contained in Section 23 of the Act, which is applicable to corporations, partnerships and individuals, in general. That section is headed "Deductions from Gross Income" and provides that "In computing net income there shall be allowed as deductions: (a) expenses; (b) interest; (c) taxes generally; (d) taxes of shareholder paid by corporation; (e) losses by individuals; (f) losses by corporations;" and under sub-section (g) that "The basis for determining the amount of deduction for losses sustained, to be allowed under sub-section (e) or (f), shall be the same as is provided in Section 113 for determining the gain or loss from the sale or other disposition of property." If Congress had intended that the loss to be deducted by insurance companies under Section 204 (c) 5 should be computed in acccordance with Section 113 of the Act as it intended with reference to subdivisions (e) and (f) of Section 23 of the Act, why did it not so specifically provide, as it was careful to do in Section 23 (g)? The obvious answer to this question is that Congress was fully conversant with the pertinent decisions of this Court and the distinctions there drawn between income and capital, and knew that it did not have the authority to tax as income accretions to capital assets which had accrued to insurance companies prior to the effective date of the new clauses of the Revenue Act of 1928.

Congress likewise knew that under the decisions of this Court it was without power to levy a tax which would be so arbitrary and capricious that its enforcement would amount to the deprivation of property without due process of law.

The statement of counsel for the Collector on page 17 of their brief that "Although there are in the sections relating to insurance companies *a few* references to the general provisions of the Act, the usual treatment seems to have been not to make reference to other provisions of the Act but rather to rely upon the introductory provisions of Section 4 * * *" is hardly accurate. The sections which apply particularly to insurance companies other than life or mutual are Sections 204 to 207 inclusive. Section 204 is divided into various sub-sections.

Thus, sub-section (a) imposes the tax of 12% "in lieu of the tax imposed by section 13 of this Title." Sub-section (b) contains definitions of gross and net income of such insurance companies. The contents of this sub-section are all matters peculiar to this type of insurance company and are not elsewhere covered in the Act, with the exception of the inclusion in gross income of "gain during the taxable year from the sale or other disposition of property." Obviously, therefore, there was no occasion to have cross-references in this sub-section to any other sections of the Act, except in connection with a definition of "gain," if such had been the intention of Congress. Sub-section (c) sets forth the deductions allowed. As

already stated there are ten sub-divisions of this sub-section. In seven of these sub-divisions there are cross-references to sections 22 and 23. Two of the sub-divisions are complete in themselves and require no cross-reference. The tenth sub-division allows as a deduction "(5) Losses sustained during the taxable year from the sale or other disposition of property" and contains no cross-reference. Sub-section (d) of section 204 contains a cross-reference. Sub-section (e) is complete. Sections 205, 206 and 207 all contain cross-references.

In other words, instead of saying as counsel for the Collector do that "There are *"a few* references to the general provisions of the Act" it would be more accurate to say that with the exception of the two clauses here under consideration there is a cross-reference in every single provision of the sections covering this type of insurance company which does not contain matter peculiar to such insurance companies, or which is not self-sufficient. The only possible conclusion, therefore, from the failure of Congress to insert a cross-reference after these new provisions is that it was not intended that gains of insurance companies should be computed in accordance with Sections 111-113 inclusive but that they should be computed on the basis of the effective date of Section 204 (b) (1) (B), in accordance with the existing law as set forth in the various decisions of this Court.

The reason for this distinction is obvious from

the history of the taxation of insurance companies under the various Revenue Acts. As already stated, all insurance companies were taxed in the same manner as other corporations from 1913 until 1921. In the administration of these earlier income tax Acts the Treasury Department had encountered serious difficulty in determining the true net income of certain kinds of insurance companies. It had been found that the general accounting methods applicable to other types of corporations were inadequate for such companies. Accordingly, in the drafting of the Revenue Act of 1921 life insurance companies and insurance companies other than life or mutual were segregated from other corporations in Sections 242 to 247 inclusive.

At the same time the definitions of gross income for such insurance companies as set forth in sections 244 and 246 of that Act did not include "gain during the taxable year from the sale or other disposition of property," nor did the deductions allowed such companies include losses so realized. This situation continued under the Revenue Acts of 1924 and 1926.

In the report, dated December 7, 1927, of the Ways and Means Committee of the House of Representatives, to which had been referred the Bill (H. R. 1, afterwards the Revenue Act of 1928) appears the following statement:

> "The bill embodies a proposed new arrangement for the income tax title. The basis for the arrangement is the distribution of the provisions

by two classifications: General Provisions and Supplemental Provisions. There are a few Introductory Provisions.

"*The General Provisions are those which apply to the ordinary transactions of the ordinary classes of taxpayers. It is believed that approximately 80 per centum of the taxpayers who file returns under the new Act will find in the General Provisions practically all the income tax statute law of interest to them.* The General Provisions are divided into Parts.

"The Supplemental Provisions comprise all provisions of the income tax title other than the General Provisions and the Introductory Provisions. *In the main, the Supplemental Provisions are those which apply only to extraordinary classes of taxpayers or which apply only to the extraordinary transactions of ordinary classes of taxpayers.* The Supplemental Provisions are divided into Supplements." (Italics ours.)

Thus, insurance companies were intentionally included in Supplement G because they are among the "extraordinary classes of taxpayers," to which the General Provisions were largely inapplicable.

When the Bill was before the Senate for consideration, Senator Reed of Pennsylvania called attention to the fact that while a mutual insurance company had to pay a tax on profits realized from its investments, stock companies were exempt. It was thereupon agreed that the Act should be amended so as to put insurance companies, other than life or mutual, "upon the same basis" in this respect as mutual

companies. To accomplish this the proposed Revenue Act of 1928 was appropriately amended by the insertion of the two clauses here under consideration so as to include in the gross income of such companies "gain during the taxable year from the sale or other disposition of property," and to allow as a deduction losses similarly sustained.

It is to be noted that in the legislative history of Section 204 (b) (1) (B) of the Revenue Act of 1928, which is set forth in full in Appendix C of the brief filed for the Collector at page 41, there is no indication of a desire on the part of Congress to penalize insurance companies other than life or mutual. Senator Reed simply called attention to the fact that under the existing law profits realized by mutual insurance companies were taxable, while those realized by companies other than life or mutual were not. By putting the two classes of companies "on the same basis" it was intended that after the effective date of the Revenue Act of 1928 insurance companies other than life or mutual should pay an income tax on profits accrued and realized after that date. Congress did not intend that when an insurance company, other than life or mutual, disposed of certain of its investments subsequent to January 1, 1928, it should be subject to the payment of an income tax upon the increment of such investments which might have entirely accrued five or ten years before the effective date of the Act, during seven years of which this gain from the sale or other disposition of property would have been exempt from taxation. To

have subjected them to a tax on such basis would not have been to put such companies "on the same basis" as mutual companies but to have penalized them to the great disadvantage of the thousands of policy holders and stockholders of such companies throughout the United States.

It is submitted that such an intention on the part of Congress must be clearly and unequivocally expressed before such a construction of a taxing statute is adopted by this Court. It is further submitted that clear and unequivocal evidence of such an intention is entirely lacking in the present instance.

The history of the Revenue Act of 1928 discloses that the Act was approved May 29, 1928, and became effective as of January 1, 1928; that for a period of seven years, gain from the sale or other disposition of property by insurance companies, other than life or mutual, had not been subject to income tax; that in the passage of the Act of 1928 attention was called to the fact that mutual insurance companies were subject to such a tax, whereupon the Act was amended and section 204 (b) (1) (B) was inserted. It is submitted that the construction contended for by the Treasury Department is unreasonable in that it is not justified by the terms of the Act itself, is arbitrary in that it subjects these insurance companies to an unwarranted hardship which was never contemplated by Congress, and which if persisted in will render this provision of the Act unconstitutional not only because it will attempt to

levy an income tax upon that which is capital but also because its enforcement would amount to deprivation of property without due process of law within the inhibition of the Fifth Amendment of the Federal Constitution. **Nichols v. Coolidge, 274 U. S. 531 (1927); Blodgett v. Holden, 275 U. S. 142 (1927); Untermeyer v. Anderson, 276 U. S. 440 (1927).**

It has been repeatedly held by this Court that "In case of doubt they (statutes levying taxes) are construed most favorably against the Government and in favor of the citizen." **Gould v. Gould, 245 U. S. 151 (1917).**

It is submitted that under the existing circumstances this Court should adopt a construction which both carries out the intention of Congress without undue hardship to the taxpayer and removes all doubt as to the constitutionality of the provision. This can only be done by holding that gain realized by insurance companies other than life or mutual during the taxable year shall be included in the gross income of such companies to the extent that such gain has accrued since January 1, 1928, the effective date of the Revenue Act of 1928.

Judge Kirkpatrick, in upholding the contention of the appellee in this connection, says (p. 27 of Appellant's Brief in Companion Case, No. 547):

> "The government's contention is simply that since there are no exceptions or additional provisions in Sec. 204 or, for that matter, anywhere in Supplement G, affecting the basis for deter-

mining gain or loss of stock fire, casualty or marine insurance companies, Sec. 113 was intended to apply and to furnish the basis. It is further argued that only by so holding can stock insurance companies of the classes referred to be placed upon a parity with mutuals, since the latter in case of property sold during 1928 must compute the gain on the basis of its 1913 value.

"But the statute (Title 1 of the Act) is an income tax law. The predominant intention running through all provisions is to tax income only. The Sixteenth Amendment is a grant of power to lay taxes upon incomes and the presumption is that Congress intended to act within its constitutional limits. Whatever may be read into the Act by implication must yield to a construction which will uphold the Act, unless a contrary intention is so clearly indicated as to make any other interpretation impossible with reason. This is the basis of the plaintiffs' position for they say that the construction contended for by the government would result in imposing a tax upon something not income at all but an accrual to capital matured before the passage of the Act.

"A review of decisions under the Corporation Excise Tax Act of 1909 sustains the plaintiffs' view."

And again (p. 35, Appellant's Brief, No. 547):

"Of course, if it appeared clearly and unequivocally from the terms of the Act of 1928 that Congress intended to apply the measure for

gains, provided for by Sec. 113, to insurance companies of the plaintiff's class the question of constitutionality would have to be met. But there are many things in the language and structure of the Act of 1928 which strongly suggest that Congress did not so intend and I cannot agree that the conclusion that Sec. 113 was intended to apply to the tax imposed by Sec. 204 (b) (1) (B) is necessary, or even permissible. The tax imposed by Sec. 204 is expressly stated to be 'in lieu of the tax imposed by Sec. 13 of this title.' Sec. 13 imposed a 12% tax on the net income of corporations generally which is the amount imposed by Sec. 204 and the effect of the phrase quoted above is to emphasize the intention to make Sec. 204, a scheme or code of taxation, complete in itself, applicable to insurance companies other than life or mutual without reference to the general provisions of the Act. No other reason can be suggested for providing that a tax of 12% should be 'in lieu of' a tax at the same rate already fixed for corporations generally.

"This intention appears more clearly when Sec. 204 is examined in all its parts. Whenever it was intended to incorporate into Sec. 204 any of the general provisions of the Act such provisions were specifically referred to and included by express language."

It is not to be presumed that Congress intended that the words used by it should be given a meaning not consonant with their recognized meaning, as established by the decisions of this Court.

The meaning of the word "income" in income tax acts is definitely settled by the decisions of this Court.

In the case of **Bowers, Collector of Internal Revenue v. Kerbaugh-Empire Co., 271 U. S. 170,** decided May 3, 1926, which presented a question arising under the Revenue Act of 1921, suit having been brought by the plaintiff to recover taxes assessed against it and paid under protest, this Court said (p. 174):

> "'Income' has been taken to mean the same thing as used in the Corporation Excise Tax Act of 1909, in the Sixteenth Amendment, and in the various revenue acts subsequently passed. Southern Pacific Co. *v.* Lowe, 247 U. S. 330, 335; Merchants' L. & T. Co. *v.* Smietanka, 255 U. S. 509, 519. * * *
>
> "In determining what constitutes income substance rather than form is to be given controlling weight. Eisner *v.* Macomber, *supra,* 206."

In the case of **Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509,** decided March 28, 1921, involving the income tax Act of 1916, as amended by the Act of 1917 (p. 518):

> "It is obvious that these decisions (under the Corporation Excise Tax Act of August 5, 1909) in principle rule the case at bar if the word 'income' has the same meaning in the Income Tax Act of 1913 that it had in the Corporation Excise Tax Act of 1909, and that it has the same scope of meaning was in effect decided in Southern Pacific Co. v. Lowe, 247 U. S. 330,

335, where it was assumed for the purposes of decision that there was no difference in its meaning as used in the act of 1909 and in the Income Tax Act of 1913. There can be no doubt that the word must be given the same meaning and content in the Income Tax Acts of 1916 and 1917 that it had in the act of 1913 * * * there would seem to be no room to doubt that the word must be given the same meaning in all of the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of this Court."

Any increased value that accrued before January 1, 1928, the effective date of the new clause in question, is capital and not income.

As already stated, under the Income Tax Acts of 1921, 1924 and 1926, or in other words, from January 1, 1921, to January 1, 1928, Congress had seen fit to describe the gross income of insurance companies other than life or mutual as the "combined gross amount earned during the taxable year, from investment income and from underwriting income" as therein set forth. During this entire period gain realized by such companies from the sale or other disposition of property was not taxed. To give this new provision, clause (b) (1) (B) of Section 204 of the Revenue Act of 1928, the construction contended for by the Treasury Department would be to levy a tax upon gain which, although realized during the taxable year, had accrued over a period of

fifteen years prior to the effective date of the Act, during seven of which years such gain from the sale or other disposition of property was not subject to income tax.

It has been repeatedly held by this Court that such accretion to capital assets represents capital and not income, and is therefore not subject to tax as income.

These cases are set forth on pages 7 to 19 inclusive of Appellant's brief filed in this Court in the companion case of The Insurance Company of the State of Pennsylvania v. MacLaughlin, No. 547, October Term, 1931. For the sake of brevity these cases will not be repeated at this point.

Applying these authorities to the facts presented in the case at bar, we are led to the inevitable conclusion that the value of the capital assets of insurance companies (other than life or mutual) on December 31, 1927, represented capital and that upon the conversion of the same into cash at a subsequent date they were entitled "to have this capital restored," to apply the language of Mr. Justice Stone in **Burnet v. Sanford and Brooks Company, 282 U. S. 359,** "before there is a capital gain taxable as income," under the new provision of Section 204 of the Revenue Act of 1928.

Counsel for the Government in their brief attempt to minimize the effect of these authorities by arguing that the language quoted from **Doyle v. Mitchell Brothers, 247 U. S. 179; Hays v. Gauley Mountain Coal Co., 247 U. S. 189; Lynch v. Turrish, 247 U. S. 221,**

and **Southern Pacific Co. v. Lowe, 247 U. S. 330,** in the Appellant's brief filed in this Court in the companion case is mere dictum and that none of these cases holds that Congress cannot by an Act passed after the effective date of the Sixteenth Amendment require the inclusion in gross income of all gains which have accrued since that date.

Although the two cases first named involve the construction of the Corporation Excise Tax Act of 1909, and although March 1, 1913, happened to be approximately the effective date both of the Revenue Act of 1913 and the Sixteenth Amendment, these facts do not explain the repeated statement in those cases that accumulations that accrued to a corporation prior to the effective date of those Acts was capital and not income. While the Sixteenth Amendment was necessary to empower Congress to levy an income tax without apportionment among the States no constitutional amendment was needed in order to give Congress sufficient authority to levy an excise tax measured by income. It has been repeatedly held by this Court that the meaning of the word "income" is identical under the Excise Tax Act of 1909 and under the various Income Tax Acts beginning with that of 1913 and extending through that of 1928. When, therefore, in these earlier cases it was stated by this Court that accumulations to a corporation prior to the effective date of the Excise Tax Act of 1909 or of the Income Tax Act of 1913 represented capital and not income, it is submitted that those rulings have a direct bearing upon the question here

presented, that these cases speak for themselves, that the language used is unequivocal, and that when Justice Pitney says, in **Southern Pacific v. Lowe, supra,** that "We are bound to consider accumulations that accrued to a corporation prior to January (March) 1, 1913, as being capital not income," it represents the pronouncement of this Court on this subject, and until reversed must be regarded as the law of the land.

A reasonable construction should be adopted, which would uphold the Act.

Wherever clauses of an Act are susceptible of a reasonable construction to avoid unconstitutionality, such construction should be adopted. As stated in **Reinecke, Collector of Internal Revenue v. Northern Trust Company (1928), 278 U. S. 339,** at page 348, by this Court:

> "Doubts of the constitutionality of the statute, if construed as contended by the government, would require us to adopt the construction, at least reasonably possible here, which would uphold the act."

In **United States v. Jin Fuey Moy (1916), 241 U. S. 394,** Justice Holmes said, at page 401:

> "A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score. United States *ex rel.* Atty. Gen. *v.* Delaware & H. Co., 213 U. S. 366, 408."

In **Panama Railroad Co. v. Johnson** (1924), 264 U. S. 375, 395, Justice Van Devanter said, at page 390:

> "But, as this court often has held, 'a statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score.' United States *v.* Jin Fuey Moy, 241 U. S. 394, 401; United States *v.* Delaware & Hudson Co., 213 U. S. 366, 407, 408; Baender *v.* Barnett, 255 U. S. 224. The question arises, therefore, whether the statute is fairly open to such a construction."

It is submitted that the construction of Section 204 (b) (1) (B) of the Revenue Act of 1928 contended for by the Commissioner in the instant case would render that clause unconstitutional for the reasons that it would result in taxing capital under the guise of income, and that it would lay a tax so arbitrary and capricious that its enforcement would amount to deprivation of property without due process of law within the inhibition of the Fifth Amendment. **Doyle, Collector of Internal Revenue v. Mitchell Brothers Co., supra; Southern Pacific Co. v. Lowe, supra; Nichols v. Coolidge, supra.**

It is further submitted that in order to avoid grave doubts upon the question of the constitutionality of this provision the reasonable construction contended for by the Appellee should be adopted by this Court.

Comments on Authorities Relied on by Appellant.

On page 24 of their brief, counsel for the Collector refer to a number of cases decided by this Court for

the proposition that "gains on the sales of securities may be subject to income tax under the Sixteenth Amendment." This proposition of law has been so frequently decided that it requires no further comment than to say that it is without application to the question presented in the instant case.

At the top of page 26 of the Collector's brief, it is stated "In many of these cases it seems to have been assumed, at least by this Court, that Congress could tax all of such gain without deduction of that part of it which was attributable to accretions prior to the effective date of the applicable Act," citing certain authorities. It is submitted that an examination of these authorities shows very clearly that no such assumption can be attributed to this Court.

The first case relied upon by the Collector is *Goodrich* v. *Edwards,* 255 U. S. 527. Two transactions were involved in that case. In the first the plaintiff in error in 1912 purchased certain shares of stock for $500. This stock was worth $695 on March 1, 1913, and was sold in March, 1916, for $13,931.22. The income tax was assessed on the difference between the value of the stock on March 1, 1913, and the amount for which it was sold. This procedure was obviously correct and was held to be so by this Court.

In the other transaction the securities in question originally cost the taxpayer $291,600. On March 1, 1913, the value of this stock was $148,635.50. It was sold in 1916 for $269,346.25. Although it was thus apparent that the stock involved was of less value on

March 1, 1913, than when it was acquired and that it was ultimately sold at a loss to the owner, nevertheless the Collector assessed the tax on the difference between the value on March 1, 1913, and the amount for which it was sold. In the argument in this Court the Government confessed error in the judgment entered in its favor with respect to this assessment. This Court held that the word "gain" as used in the Income Tax Acts meant an actual gain to the taxpayer in excess of cost and not simply with reference to an arbitrary date, in this instance March 1, 1913. There having been no actual gain in this instance, the judgment of the District Court in this respect was reversed.

The mere statement of the facts involved in this case conclusively proves that it has no direct bearing upon the question here presented.

Taft v. *Bowers,* 278 U. S. 470 and *Cooper* v. *United States,* 280 U. S. 409, are also relied upon by counsel for the Commissioner. These cases both involve the taxability of profits derived by the donee as represented by the difference between the cost of the property in question to the donor and the price realized by the donee. These cases also have nothing to do with the question involved in this case of whether the increment accrued prior to December 31, 1927, to insurance companies (other than life or mutual) represents income or capital.

In the case of *Taft* v. *Bowers, supra,* the decision was simply that Congress had power to require that

for purposes of taxation the donee should accept the position of the donor in respect to the thing received; that the donee simply stepped into the shoes of the donor, in respect to taking the property subject to the burden of the income tax law as in other respects.

This Court very properly refused to give its sanction to the argument which, if adopted, would have made easy the evasion of tax liability on property previously impressed with such liability in favor of the Government.

As said by this Court in that case (p. 482):

> "Could he, contrary to the express will of Congress, by mere gift enable another to hold this stock free from such right, deprive the sovereign of the possibility of taxing the appreciation when actually severed, and convert the entire property into a capital asset of the donee, who invested nothing, as though the latter had purchased at the market price? And after a still further enhancement of the property, could the donee make a second gift with like effect, etc.? We think not."

In the case of *Cooper* v. *United States, supra,* this Court held that the gift provision of the Revenue Act of 1921 is not unconstitutional because it requires gains from transactions, completed prior to the passage of the Act but within the taxable year, to be treated as part of the donee's gross income.

On page 26 of their brief counsel for the Commissioner set forth an excerpt from the opinion of this Court in *Eisner* v. *Macomber,* 252 U. S. 189, 212. In

passing upon the question of whether stock dividends constituted income and were therefore subject to the Income Tax Act of 1916 this Court, speaking through Justice Pitney, said:

> "It is said that a stockholder may sell the new shares acquired in the stock dividend; and so he may, if he can find a buyer. It is equally true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income, and *so far as it may have arisen since the Sixteenth Amendment* is taxable by Congress without apportionment. The same would be true were he to sell some of his original shares at a profit. (Italics ours.)"

In this connection it must be remembered that the taxpayer in *Eisner* v. *Macomber, supra,* was an individual who had at all times been subject to a tax upon capital gains since the effective date of the earliest of the modern Income Tax Acts, March 1, 1913. Therefore, as limited to such a taxpaper this language correctly sets forth the law as laid down by this Court.

As so frequently happens, however, when one or two sentences are taken out of their context, the language is misleading. The true position of the Court in that case can only be gathered by a study of the entire opinion. This excerpt must therefore be considered in conjunction with the definition of income set forth on page 207:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained

through a sale or conversion of capital assets, *to which it was applied in the Doyle case.* (Italics ours.).

The Doyle case referred to by Justice Pitney is the case of **Doyle, Collector of Internal Revenue v. Mitchell Brothers Co. supra,** in which it was decided by this Court that under the Corporation Excise Tax Act of 1909 the tax was to be measured only by that portion of the gain realized by the taxpayer from the conversion of capital assets during the taxable year, which had accrued subsequent to January 1, 1909, the effective date of the Act. In that case this Court expressly held that the increment which had accrued to such capital assets between the date of purchase and December 31, 1908, when realized, constituted capital and not income.

A full discussion of this case is set forth on page 7 of the brief filed in this Court in the companion case of The Insurance Company of the State of Pennsylvania, Appellant, *v.* MacLaughlin, Appellee, No. 547, October Term, 1931.

On page 16 of their brief counsel for the Collector attempt to draw some comfort from the fact that Section 207 provides: "The gross income of insurance companies subject to the tax imposed by Sections 201 or 204 shall *not* be determined in the manner provided in Section 119," from which they attempt to argue that in spite of the complete definition of gross income of insurance companies other than life or mutual set forth in Section 204 (b) it was necessary

to specifically provide that gross income of such companies should not be determined in the manner provided in Section 119 because otherwise Section 119 being a general clause would have applied to this type of company. It is submitted that the explanation of Section 207 is that it was inserted by the draftsman out of an excess of caution.

The same thing applies to Section 205 dealing with net losses. This Section provides: "The benefit of the special deduction for net losses allowed by Section 117 shall be allowed to insurance companies subject to the tax imposed by Sections 201 or 204, under regulations prescribed by the Commissioner with the approval of the Secretary."

If the argument of counsel for the Collector is sound with reference to Section 207 then the insertion of Section 205 was unnecessary because being a general section Section 117 would have applied to insurance companies other than mutuals without the express reference contained in Section 205. In other words, Sections 205 and 207 are of no assistance whatever in determining the question here presented and the explanation for their inclusion in the Act is that the draftsman inserted them out of an excess of caution, in the one case to show that Section 119 did not apply and in the other case to show that Section 117 did apply.

Counsel for the Collector attempt to belittle the construction contended for by Appellee by the use of the adjectives "unreasonable" and "novel," stating

at page 24 that "apparently it has never occurred to anyone except those now attacking the 1928 Act, that the contention here made was worth making." Of course, the obvious answer to such a statement is that this case is sui generis, that its facts are peculiar, and have never been involved in any other case in this Court.

In the argument in the District Court and in the Circuit Court of Appeals, counsel for the Collector relied primarily upon two cases: *Smietanka* v. *First Trust & Savings Bank,* 257 U. S. 602 (1921), and *Merchants Loan & Trust Co., Trustee* v. *Smietanka,* 255 U. S. 509 (1920), which they contended controlled the present case. The mind of counsel has apparently been disabused in this respect by the very adequate treatment of these two cases by the District Court in its opinion. In their present brief they refer only in passing to Merchants Loan & Trust Co., Trustee *v.* Smietanka, *supra,* in a note at the bottom of page 24. At the end of their brief, on page 29, counsel admit that "the point (here presented) seems not to have been raised" in that case.

The point not only was not raised in that case, but upon analysis the case is clearly distinguishable upon its facts. The discussion of these decisions by the District Court in its opinion is set forth on page 31 of the Appellant's brief filed in this Court in the companion case of The Insurance Company of the State of Pennsylvania *v.* MacLaughlin, No. 547, October Term, 1931.

As already stated, so far as we know no case

has ever arisen in this Court involving the facts here presented. A similar case might arise in the future involving a life insurance company which, under the Revenue Act of 1928, is taxable under Sections 201 to 203 inclusive. Life insurance companies like insurance companies other than life or mutual were taxable with respect to gains realized from the sale or other disposition of property from 1913 until 1921. In the drafting of the Revenue Act of 1921 the definition of the gross income of both life insurance companies and insurance companies other than life or mutual excluded gains. This situation continued under the Revenue Acts of 1924 and 1926 until 1928 when as a result of the Reed amendment the gains realized by insurance companies other than life or mutual were again included in the definition of the gross income of such companies. The provisions, however in the 1928 Act referring to life insurance companies remained substantially the same in the 1928 Act as in the preceding Acts of 1926, 1924 and 1921, with the result that such gains by life insurance companies are still not subject to tax.

If the construction of Section 204 (b) (1) (B) of the 1928 Act, contended for by the Collector, is adopted by this Court and is held to be constitutional, it would mean that the present situation with reference to the non-taxability of such gain by life insurance companies might continue for an unlimited period and then at the election of Congress at some future date twenty-five, fifty or even one hundred years from now, Congress could adopt a new Income Tax Act which would tax the gain of life insurance companies realized during the taxable year which

had accrued from January 1, 1913, although during all of these years such increment, if realized, would not have been taxed and would have been regarded by such companies as a part of their capital.

CONCLUSION.

The conclusion inevitably reached is that the gradual advance in the value of property of insurance companies (other than life or mutual) before January 1, 1928, the effective date of the new clause of Section 204 of the Revenue Act of 1928, when converted, in no just sense constitutes gain from the sale or other disposition of property during the taxable year 1928, and that, in view of the treatment of insurance companies as a special class of taxpayer and of the well-established doctrine that Congress is presumed to have legislated with a constitutional intent, such previously accrued value was not intended by Congress to be considered income. It constitutes and can be treated only as increase of capital.

It follows that the action of the lower court in holding that the basis to be used in computing gain resulting from the sale or other disposition of property by insurance companies (other than life or mutual) on and after January 1, 1928, is the fair market value as of December 31, 1927, and not the fair market value as of March 1, 1913, or other basis as provided by Section 113 of the Act was proper, and that the question certified in this case should be answered in the affirmative.

EDWARD M. BIDDLE,
ROBERT C. WALKER,
ROBERT T. MCCRACKEN,
Attorneys for Appellee.

SUPREME COURT OF THE UNITED STATES.

No. 548 and 547.—October Term, 1931.

Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania, 548 *vs.* Alliance Insurance Company of Philadelphia.	On Certificate from the United States Circuit Court of Appeals for the Third Circuit.
The Insurance Company of the State of Pennsylvania, 547 *vs.* Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania.	On Certificate from the United States Circuit Court of Appeals for the Third Circuit.

[May 16, 1932.]

Mr. Justice Stone delivered the opinion of the Court.

Appellee in No. 548, a Pennsylvania stock fire and marine insurance corporation, brought the present suit in the District Court of Eastern Pennsylvania, to recover income tax for the year 1928, alleged to have been illegally exacted. Under the Revenue Acts of 1913, 1916, 1917 and 1918, stock fire insurance companies were taxed upon their income, including gains realized from the sale or other disposition of property, accruing subsequent to March 1, 1913; but by the Revenue Acts of 1921, 1924 and 1926, gains of such companies, from the sale or other disposition of property, were not subject to tax, and losses similarly incurred were not deductible from gross income.

Supplement G of the Revenue Act of May 29, 1928, 45 Stat. 791, 844, c. 852, § 204 (a) (1), effective as of January 1st of that year, taxed the income of insurance companies, and by § 204 (b) (1), applicable to insurance companies other than life or mutual, gross income was defined as including "gain during the taxable year from the sale or other disposition of property." In 1928 appellant received a profit from the sale of property acquired

before that year, upon which the Commissioner assessed a tax computed, on the basis prescribed by § 113 of the Act, by including in the taxable income all the gain attributable to increase in value after March 1, 1913, and realized in 1928. The District Court held that only the accretion of gain after January 1, 1928, was taxed, and gave judgment in the Company's favor for the tax collected in excess of the amount so computed. 49 F. (2d) 361. On appeal, the Court of Appeals for the Third Circuit certified a question to this Court under § 239 of the Judicial Code, as amended by the Act of February 13, 1925, as follows:

"Under the Revenue Act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing 'gain during the taxable year from the sale or other disposition of property', acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the Act?"

The Company contends that so much of the gain as accrued before the effective date of the taxing Act was capital, which could not constitutionally be taxed under the Sixteenth Amendment, and that in any case the constitutionality of a tax upon the previously accrued gain is so doubtful as to require the taxing act to be construed as not authorizing such a levy.

In No. 547, decided by the same District Court, and involving similar facts and the same taxing statutes, the Court of Appeals for the Third Circuit certified the following question:

"If the basis to be used by an insurance company (other than a life or mutual insurance company) in computing 'gain during the taxable year from the sale or other disposition of property', acquired before and disposed of after January 1, 1928, the effective date of the Revenue Act of 1928, be the fair market value of such property as of March 1, 1913, or other basis provided by section 113 of the Act, is the quoted provision (Section 204 (b) (1), clause (B)) unconstitutional because it taxes capital?"

The tax under this and earlier revenue acts was imposed upon net income for stated accounting periods, here the calendar year 1928, see *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363, and it is only gain realized from the sale or other disposition of property, which is included in the taxable income. Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While in-

crease in value of property, not realized as gain by its sale or other disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, see *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, it is nevertheless a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized. See *Lynch* v. *Hornby*, 247 U. S. 339; *Merchants' Loan & Trust Co.* v. *Smietanka, supra; Eldorado Coal & Mining Co.* v. *Mager*, 255 U. S. 522; *Goodrich* v. *Edwards*, 255 U. S. 527; *Walsh* v. *Brewster*, 255 U. S. 536; *Taft* v. *Bowers*, 278 U. S. 470; *Lucas* v. *Alexander*, 279 U. S. 573; *Willcuts* v. *Bunn*, 282 U. S. 216.

Here there is no question of a tax on enhancement of value occurring before March 1, 1913, the effective date of the income tax act of that year, for the Collector asserts no right to tax such increase in value. The fact that a part of the taxed gain, represented increase in value after that date, but before the present taxing act, is without significance. Congress, having constitutional power to tax the gain, and having established a policy of taxing it, see *Milliken* v. *United States*, 283 U. S. 15, 22-23, may choose the moment of its realization and the amount realized, for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in value in the earlier years, assuming without deciding that it had the power, cannot preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued, gain. If the gain became capital by virtue of the increase in value in the years before 1928, and so could not be taxed as income, the same would be true of the enhancement of value in any one year after the adoption of the taxing act, which was realized and taxed in another. But the constitutionality of a tax so applied, has been repeatedly affirmed and never questioned. The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing act. *Cooper* v. *United States*, 280 U. S. 409; compare *Taft* v. *Bowers*, 278 U. S. 470. See also *Glenn* v. *Doyal*, — U. S. —, (March 21, 1932) dismissing *per curiam*, for want of a substantial federal

question, an appeal from a decision of the Georgia Supreme Court (reported sub nom. *Norman* v. *Bradley*, 173 Ga. 482), that a state income tax on the profits realized from a sale of corporate stocks, after the passage of the act, was constitutional, though the gains had accrued prior to its enactment.

Doyle v. *Mitchell Brothers Co.*, 247 U. S. 179, and *Hays* v. *Gauley Mountain Coal Co.*, 247 U. S. 189, on which the taxpayers rely, involved the construction, not the constitutionality of the Corporation Excise Tax Act of 1909, and considerations which, in *Lynch* v. *Turrish*, 247 U. S. 221, and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, led to the construction of the income tax act of 1913 as not embracing gains accrued before the effective date of that act, are not present here.

We think it clear that the Revenue Act of 1928 imposed the tax on the entire gain realized within the taxable year. Section 204 (b)-(1) of Supplement G, which includes gain from the sale of property in the gross income of insurance companies (other than life or mutual), states no method of computing the gain. But the 1928 Act, like its predecessors, prescribed in other sections, §§ 111-113, that taxable gains from the sale of property should be determined by deducting from the net sales price the cost or the fair market value on March 1, 1913, if acquired before that date. These provisions are general in their terms, without any stated exception, and on their face are applicable alike to all gains from the sale of property taxed by the Act. They either control the computation of the gain referred to in § 204 (b) (1) or the word "gain" in that section, construed without their aid, must be taken in its ordinary sense as embracing the difference between net cost and net selling price, and so upon established principles would include in the taxable realized gain all which had accrued since the effective date of the income tax act of 1913, the first enactment adopted under the Sixteenth Amendment. See *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Merchants' L. & T. Co.* v. *Smietanka*, *supra*, pp. 519, 520. For present purposes, the Revenue Act of 1928 must be regarded as substantially an amendment and continuation of the Act of 1913.

The taxpayers insist that the omission from § 204 (b) (1) of any reference to §§ 111-113, in contrast to the inclusion in § 204 (c) of cross references to the general provisions of the Act defining deductions, evidences an intention to exclude the method of com-

puting gains prescribed by §§ 111-113, and to adopt a different method with respect to gains taxed by Supplement G. But this argument disregards the function of the general provisions of the Act, including §§ 111-113, as complementing the provisions of Supplement G, and ignores the obvious necessity of defining the deductions authorized by § 204 (c), either by cross references made in that section to the general provisions of the Act or by other appropriate means, which did not obtain with respect to the definition of gains in 204 (b) (1).[1]

This becomes evident upon an examination of the structure of the 1928 Act, which differed from that of any earlier revenue measure. "Title 1—Income Tax", with which we are now concerned, is divided into three sub-titles designated:

"Subtitle A—Introductory provisions."
"Subtitle B—General provisions."
"Subtitle C—Supplemental provisions."

Section 4 of Subtitle A provides in part: "The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such classes, as follows: . . . (c) Insurance Companies,—Supplement G . . . ." The Act, by this section and by operation of its structural arrangement, thus provided that all of the general provisions of Subtitle B, and all the general provisions of Supplements A to D, including Supplement B, in which §§ 111-113 occur, were to apply to the special classes of taxpayers referred to in Supplements E to K, unless the provisions relating to a special class restrict the operation of the general provisions or are necessarily inconsistent with them. That such was the purpose to be accomplished by the rearrangement of the

[1]It is true that §§ 204 (c), 205, and 206, relating to allowed deductions from gross income, define the deductions by specific cross references to like deductions defined in the general provisions of other sections, but as the listed deductions were intended to be exclusive, and as those allowed to insurance companies differ in many respects from those allowed to other corporations, it was an appropriate, if not necessary precaution, in enumerating them, to describe those which were allowed, either by repeating the appropriate language contained in the general sections or to incorporate it by reference. No such precaution was necessary with respect to § 204 (b). The "gain" included in gross income by that section was adequately defined by §§ 111-113, made applicable, by § 4 of Sub-title A, to the provisions of Supplement G.

taxing provisions, in the 1928 Act sufficiently appears from its legislative history.[2]

Section 204 is not, as the District Court thought, "a scheme or code of taxation complete in itself, . . . without reference to the general provisions of the act", unless specifically referred to and included by cross reference to such general provisions. An inspection of the Act discloses that Supplement G, dealing with insurance companies as a special class of taxpayers, would be unworkable without resort to the general provisions of the Act not specifically referred to in the Supplement.[3]

It would be going very far in the circumstances to say that the mere omission from § 204 of a cross reference to the definition of gain in §111-113, made applicable by the general provisions of the Act, not only excluded that definition from § 204, but substituted a different one not specifically mentioned in that or any other section. The gain taxed by § 204 (b) (1) is therefore that defined by §§ 111-113, which may constitutionally be taxed.

Both questions are answered, No.

Mr. Justice ROBERTS took no part in the consideration or decision of this case.

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[2]See Report of the Joint Committee on Internal Revenue Taxation, December 22, 1927, Document No. 139, 70th Cong., 1st Sess., p. 2, appendix p. 7; Report of the Committee on Ways and Means, December 17, 1927, H. R. No. 2, 70th Cong., 1st Sess., pp. 1, 2, 11, 12; Report of Committee on Finance, Sen. Rep. No. 960, May 1, 1928, 70th Cong., 1st Sess., pp. 17, 18. Although the bill, as originally introduced, did not contain the provision for taxing gains of stock fire insurance companies, the bill was amended by the addition of § 204 (b) (1) (B) to Supplement G, for the declared purpose of placing such insurance companies on the same basis as mutual companies, which were already taxed upon gains from the sale or other disposition of property. Cong. Rec., May 21, 1928, Vol. 69, Part 9, p. 9337; Conference Report No. 1882, p. 18.

[3]Neither § 204, which deals with the taxation of insurance companies other than life or mutual, nor the other provisions of Supplement G, contain any directions concerning such essential parts of a system of taxation as the filing of returns, time of payment, or penalties for non-payment; and no express reference is made to the obviously applicable general provisions touching upon these matters: §§ 52, 56, 146. Other important and necessarily applicable general provisions, not included or referred to in Supplement G, may be found in §§ 105, 118, 141, 142, 271-277. The provision in § 207 of Supplement G that "gross income shall not be determined in the manner provided in Section 119," is a plain indication that the general provisions contained in § 119 would apply to insurance companies in the absence of the express exception.